NEWSLETTER

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INSIDE THIS EDITION

Farewell to "tax invoices"

Despite significant technological and operational business changes, the rules regarding GST tax invoices have remained largely unchanged since GST was first introduced in 1986. However, new legislation was passed on 29 March 2022 that is intended to improve and modernise GST invoicing and record-keeping requirements.

A long-standing requirement to be able to make a GST deduction on a standard taxable supply is that a "tax invoice" must be held at the time a GST return is filed. This requirement is being repealed. Instead, the concept of "taxable supply information" (''TSI'') has been introduced and is required instead. For supplies that exceed $1,000, TSI comprises:

- the name and registration number of the supplier,
- recipient details,
- address of the recipient,
- date on which the taxable supply information is issued,
- a description of the goods of services supplied, and
- the consideration for the supply and details of the GST amount charged.

Meanwhile, the 'form' of credit and debit notes are being replaced by "supply correction information" (SCI), which is deemed to have a larger scope. The issue of a SCI is required within 28 days of the TSI being issued, or by a date agreed between the supplier and the recipient.

Record keeping requirements have been simplified as businesses are only required to keep a record of the TSI and SCI for all taxable supplies made and received. Supplies valued less than $200, will not require TSI to be issued, but in order to claim GST a

TSI must be requested from the supplier. For supplies under $200, TSI must include, name, GST registration number of the supplier, date of supply, description and amount of consideration for the supply.

The changes bring in an element of confusion, because other than the reference to 'taxable supply information' it is difficult to determine the practical effect of the changes. But because the process of 'invoicing' is so fundamental, additional time has been given to allow businesses to work through implementation of the changes, hence they apply to taxable periods beginning on or after 1 April 2023.

One change that was introduced with immediate effect is that Inland Revenue approval will no longer be required to issue buyer created tax invoices. Instead, the parties simply need to agree that the recipient will issue the invoices (or TSI from 1 April 2023) and record their reasons for doing so if it is not part of their normal terms of business. This is a positive change that is welcomed, but whether the broader changes above are also positive remains to be seen.

Taxation of capital

In March 2022 Inland Revenue released a government discussion document that contains a proposal that represents a further erosion of the principle that New Zealand does not tax capital gains.

Currently, if a person sells shares in a company and the shares were not purchased with the intention of resale (such as by a share trader), the amount derived should comprise a non-taxable capital gain. However, Inland Revenue is proposing a change in which a sale of shares could trigger a taxable dividend.

The background to the change is publicised as an 'integrity measure' to support application of the 39% tax rate, but it would apply irrespective of the applicable tax rate.

The logic is that companies and trusts can earn income on behalf of high-income individuals. In the case of a company, it can derive income which is taxed at 28% and this income could accumulate to the company over time and not be paid out as a dividend to be taxed at the shareholder's marginal tax rate. If the shares in the company are then sold to a third party, the vendor derives a non-taxable capital gain. The concern is that the value of the shares is partly tied to the amount of the retained earnings of the company, so the individual should be treated as deriving those retained earnings, i.e. a deemed taxable dividend should be triggered.

As evidence that such a change is necessary, Inland Revenue refers to the fact that since the top personal tax rate first increased to 39% in 2000, NZ has seen "a notable increase in the imputation credit account balances of non-listed companies." This would suggest that people are using companies to store value and avoid the higher personal tax rates.

The detailed proposal is that share sales by 'controlling shareholders', being someone who holds more than 50% of the voting interests in the company (including shares held by associated persons), will trigger taxable income based on the higher of:

- the accounting retained earnings, less non-taxable capital gains, plus imputation credit account (ICA) balance, or
- the ICA balance divided by the tax rate.

If a controlling shareholder only sells a portion of their shares, the taxable amount is pro-rated. To the extent the company's imputation credits feature in the above calculation(s), the shareholder will claim the amount of the credit against their tax liability and the company's ICA balance will be reduced.

Some exceptions are proposed, such as for the sale of shares in listed companies or shares held by Portfolio Investment Entities.

Finally, IRD is also proposing that companies are required to maintain a record of their 'available subscribed capital' (ASC) and capital gains. Currently, distributions by a company are not taxable to the extent they are a return of ASC or if on liquidation, a capital gain. Because companies do not have to keep a record of their ASC and capital gain amounts, it becomes difficult for the IRD to verify the non-taxable amount on a share repurchase or in a liquidation.

There is a lack of acknowledgement by the Government that profits are often retained by a company and reinvested for future growth or acquisitions. It is common for 'value' to be retained in a company for decades with no need or occasion for it to be distributed. The fact a share sale gives rise to a tax-free capital gain is a feature of our tax system.

The proposals appear to be driven by a philosophical drive to recharacterise a capital gain into a taxable gain.

Is it a 'New Build'?

On 30 March 2022, the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Act 2022 received Royal assent. Its passing into law brings with it the extension of the residential bright line period from 5 to 10 years and denial of interest deductibility for residential investment properties. The legislation itself is complex and difficult to interpret because it has been written with numerous potential fact scenarios in mind.

In summary:

- The 5 year bright line period is extended to 10 years for properties purchased after 27 March 2021.
- Interest deductions will not be allowed for properties purchased after 27 March 2021.
- For properties owned prior to 27 March 2021, interest deductions will be phased out over time from 1 October 2021.

However, if a property meets the definition of "new build land":

- the bright line period remains at 5 years for a person if they acquired it within 12 months of it meeting the definition of "new build land", and
- interest will remain deductible for 20 years after the date the code compliance certificate was issued, including for subsequent purchasers of the land.

As a result, the definition of what comprises "new build land" is important. There were additions to the definition of "new build land" from when the bill was initially introduced. In its final form, "new build land" includes:

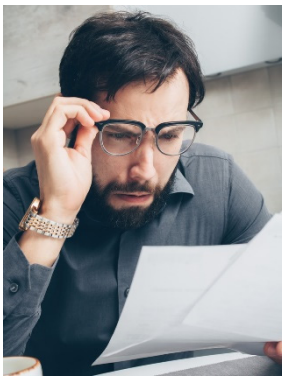
- land with a self-contained residence that was issued a code compliance certificate on or after 27 March 2020,
- land where there is an agreement to add a self-contained residence and a code compliance certificate will be issued on or after 27 March 2020,
- land that had a hotel or motel that was converted to self-contained residences and the conversion was completed on or after 27 March 2020 as evidenced by Council or building consent records,
- a dwelling that has been on the earthquake-prone buildings register, but remediated and removed from the register on or after 27 March 2020, as evidenced by a code compliance certificate issued on or after 27 March 2020 or Council records, and
- where the cladding of a leaky home has been substantially (at least 75%) replaced and a code compliance certificate was issued on or after 27 March 2020.

As alluded to above, the rules become more complex in non-standard situations. For example, if a person completes a subdivision, their acquisition date for the resulting land dates back to when the title for the undivided land was registered to them. But if a person acquires land as a result of a subdivision completed by another person, their acquisition date is when they entered into the agreement to acquire the subdivided land.

If subdivided land has both an 'old' house and a new build constructed on it, then the portion of the land on which the new build is constructed may qualify as "new build land", while the balance would not. This type of scenario can then give rise to apportionment issues in relation to interest expenditure and application of the 5 year versus 10 year bright line periods.

Care needs to be taken when applying the rules to ensure the relevant provisions are first identified and then correctly interpreted.

Changes to trust disclosures



Two changes have recently surfaced in relation to trusts and the disclosure of trust information.

Firstly, the Tax Administration (Financial Statements—Domestic Trusts) Order 2022 was made on 7 March 2022. This Order sets minimum standards for financial statements prepared by trusts.

The Order applies to income years ending on or after 31 March 2022 and to trusts that derive assessable income in a tax year. Certain trusts are excluded, such as non-active trusts, charitable trusts and foreign trusts.

Pursuant to the Order, most trusts will have to prepare financial statements that include a statement of profit and loss and a statement of financial position. If a trust has income and expenditure of less than $100,000 and assets of less than $5m it will qualify for 'simplified reporting'.

If a trust qualifies for simplified reporting

the financial statements do not need to include certain information, such as a statement of accounting policies, a fixed asset register and details of transactions between the trust and associated persons (unless the transaction was at a market rate). While financial statements are not actually filed with the tax return, they must be made available to Inland Revenue if requested. In most cases, the Order might be of no effect if financial statements are already prepared.

Secondly, and having a wider impact, the amount of information that is required to be supplied to IRD as part of the trust tax return (IR6) has significantly increased. The additional disclosure required includes:

- profit and loss, asset and equity information, including disclosure of untaxed realised gains, financial arrangement liabilities with associated persons and drawings (irrespective of whether an IR10 is filed),
- the amount and nature of all settlements made to the trust in the income year, including a breakdown of settlements in the form of cash, shares, services, land, buildings and 'other',
- the amount and nature of all distributions made by trustees in the income year, including a breakdown of distributions in the form of debt forgiveness, use of property below market value, corpus, trust assets, etc., and
- the name, date of birth, jurisdiction of tax residence and IRD number of settlors, beneficiaries, and individuals with a power of appointment.

The level of information now required is likely to impact the time and cost required to complete a trust tax return. Inland Revenue has stated in a recent discussion document that it will use the additional information to determine how trusts are being used and what measures could be considered to prevent under-taxation from the use of trusts.

Snippets

Covid-related costs

On 30 March 2022 the IRD released an interpretation statement (IS 22/01) regarding the deductibility of costs incurred due to Covid-19. It addresses the uncertainty around the deductibility of costs incurred as a result of the pandemic. Employee-related costs incurred due to Covid-19 include:

- relocating employees,
- retaining teams in New Zealand,
- incentive payments,
- provision of health and wellbeing services, and
- redundancy payments.

IS 22/01 states that in general, costs that relate to the employees of a business should be deductible but note that consideration may be required to determine if the costs are capital in nature and therefore non-deductible, such as persons engaged to work on the installation of a capital asset.

Repairs and maintenance in relation to assets that are temporarily unavailable for use in deriving income due to Covid-19 restrictions or temporary downsizing of the business should generally be deductible.

Finally, payments to terminate a lease or incentivise new tenants to enter a lease should be deductible under section DB 20C and section DB 20B respectively. While costs incurred to keep teams appropriately distanced in a workplace should also be deductible, unless they are capital in nature (such as a renovation to expand a building).

A charitable world

There are over 28,000 registered charities in New Zealand. To register, the organisation must show that it has a charitable purpose; to relieve poverty, advance education, advance religion or be beneficial to the community. But some examples make you wonder.

The 'Church of the Flying Spaghetti Monster', is an organisation that is legally recognised as a religion in New Zealand. The church is based not on a foundation of evidence, but of community, as told by those who have been touched by his 'noodly appendage'. Despite its light-hearted nature, the church exposed some real issues as to the legitimacy of some organisations that apply for charitable status.

In 2015, the U.S. government recognised Jediism as an international ministry. However, the Temple of the Jedi Order was refused charitable status in the U.K. because it was not primarily focused on charitable purposes. Or is the U.K. less 'charitable'?

Iglesia Maradoniana is a religion that was formed to worship Diego Maradona, the late Argentine football player. The religion includes 10 commandments that include the ball is never soiled, honour the temples where he played and his sacred shirts, and love football above all else.

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