NEWSLETTER

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Staff News

Viv Nockels' Retirement

After working for the firm since its inception in 1989, Viv Nockels is retiring at the end of August. Viv has fulfilled many roles in this time, and apart from working closely with many clients on their accounting and tax work, she has proved invaluable in being our go-to person on administration and IT system fixes. Viv and her husband, Stuart, are keen travellers and are already scheduled to take off up north in their campervan following her last day with us. They also have young grandchildren who they both look forward to spending more time with.

We will miss Viv for her common sense, problem solving ability and dedication to her work, and she will leave a large gap in our firm. Viv has enjoyed building close relationships with many of you, and we are sure you think highly of her too.

We do thank Viv very much for her time with us and wish her and Stuart all the very best for their years ahead.

We will be in touch as we reallocate Viv's work amongst our staff, but please call either John or Andrew direct in the interim regarding any matters that may arise.

We also wish to **welcome Nicole Williams** who has joined us on a part-time basis as an Intern from UCOL Palmerston North. Nicole is from Levin and has worked for Contact Energy in recent years prior to following her long-held ambition to study and work in Accountancy.

You may also have some contact with **Kathryn Perigo** who is assisting us with the compliance aspect of the Anti-Money Laundering legislation we are now strictly required to adhere to. Kathryn is returning to the workforce after having spent many dedicated years home schooling her and her husband Hoani's two children. Kathryn has wide experience in administration and previously worked for the Medical Council in Wellington.

Emailing of Fluker Denton Invoices and Statements

From 1 October 2019, we wish to commence emailing our invoices and statements. Please call to let us know if you would prefer the invoices/statements to be mailed instead.

We are also aware of the increasing risk of internet fraud, and in this respect wish to highlight that you should take care in ensuring that the firm's correct bank account is being used in any online payment to us.

To minimise risk when making an online payment to us, we recommend setting up Fluker Denton Limited as a saved payee. Our bank account details are as follows:-

Bank: Westpac

Account No.: 03-0667-0196929-00

If in any doubt, please call us to confirm.

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'.

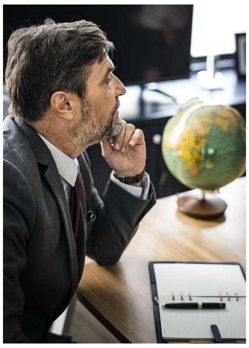
Part of the TWG's final report covered what the revenue from a CGT should be used for, and therefore proposed a number of 'spending packages'. The packages included bringing back depreciation on buildings, reducing taxes on income from savings, and increasing the income threshold for the 10.5% personal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

You versus your Trust



It is common from a layman's perspective to not appreciate the relevance of treating separate legal entities as separate. Where expenditure is incurred to derive income, it is typically deductible for income tax purposes to the person that derived the income. Documentary evidence should be held that reflects this connection to ensure the expenditure comprises an allowable deduction. The High Court recently considered this issue in the decision of Wong v Commissioner of Inland Revenue (2018).

In Wong v CIR, the taxpayer was an accountant by profession. He derived income from a consultancy business and two rental properties. He was also trustee of his family trust that derived rental income from a third property. Mr Wong financed both the consultancy business and rental properties through a number of loans and credit facilities in his personal name.

Despite reminders from Inland Revenue (IRD), Mr Wong failed to file personal income tax returns for the 2013 and 2014 tax years, and IRD raised default assessments for those years of $84,273.10 and $39,549.65, including penalties.

Mr Wong disputed the assessments, contending that the correct tax position was $951 in 2013 and nil in 2014, on the basis that interest deductions were available in respect of all three rental properties. IRD argued that interest was only deductible in respect of the two properties owned personally. However, the interest incurred for the trust property could not be deducted against his personal income as it had been incurred by the Trust, as owner of the property. To successfully challenge IRD's assessments in the courts, the onus of proof rests with the taxpayer to show how, and by how much, the IRD's assessments are wrong. With respect to the interest incurred in relation to the trust property, the TRA found in favour of IRD, emphasising that Mr Wong had failed to prove the outstanding debt and interest was paid in relation to properties owned by him personally.

The taxpayer appealed to the High Court, who found the TRA's decision correct in all respects.

A shortfall penalty for taking a 'grossly careless tax position' was also upheld. Mr Wong contended that no shortfall penalty should apply once tax losses are taken into account, i.e. no cash tax liability existed due to his personal tax losses. However, shortfall penalties are calculated based on the net shortfall as though tax is payable, and the shortfall penalty was upheld.

From a commercial perspective, it can make sense to stand back and look at a group of entities as though they are a single person, especially when they are economically owned by a single person, however, IRD and the Courts do not take the same approach.

Winding up a company

If a company does not file its annual return with the Companies Office, it may be struck off from the Companies Register. This is sometimes used as a 'short-cut' method, rather than completing the short-form company liquidation process.

However, this approach comes with some risks, for example, if a company is struck off the register whilst it has tax credits owed by Inland Revenue (IRD), the tax refund is effectively forfeited and will not be paid to the company, nor its shareholder(s), unless the company is reinstated.

Similarly, if a struck off company is still named as the owner of land (on the title), the company has to be reinstated in order to transfer the land to its correct owners and then wound up again.

Although the process of winding up a company can be lengthy, to minimise risk for both the business and its stakeholders it is recommended that the correct procedure is followed.

The process should always be commenced with a special shareholders resolution, which provides legal evidence that the majority of shareholders agree to the wind-up. It represents the point from which capital gains may be distributed tax free and is a commonly requested by IRD if they happen to review the wind-up process.

Any outstanding company liabilities are then satisfied, including trade creditors and anything owed to related parties. Surplus assets are distributed to shareholders, ensuring any legal formalities are observed depending on the type of asset (e.g. updating the land registry for any land / buildings).

For tax purposes, distributions to shareholders may be non-taxable to the extent they are comprised of share capital or capital gains, however excess amounts may comprise taxable dividends to the shareholders.

GST on land – Holdaway v Ellwood

It is common for disagreements to arise between taxpayers and Inland Revenue on the GST treatment of land transactions, but less common for these disputes to arise between a vendor and purchaser. However, this was the case in a recent High Court case, Holdaway v Ellwood (2019). The case highlights the importance of completing the GST disclosures in the Sale and Purchase Agreement (S&P) correctly.

The standard ADLS S&P agreement includes provision for both vendor and purchaser to disclose whether they are GST registered in respect of the transaction. The responses determine whether the sale is subject to GST at 15%, 0% or not subject to GST at all. If the purchaser changes their position before settlement, clause 15.5 of the S&P requires them to notify the vendor of the change.

Where both parties are GST registered, transactions are often zero-rated. Conversely, where the vendor is not GST registered, but the purchaser is and intends to use the land to make taxable supplies, the purchaser is entitled to make a “secondhand goods claim”, allowing them to make a GST claim.

In this case, both the vendor (Mr Ellwood) and purchaser (the Holdaways) had stated on the S&P that they were not, and did not intend to be, GST registered in respect of the transaction, with the purchase price stated as $355,000 ‘inclusive of GST, if any’. On the basis of the disclosures, GST did not need apply.

On the advice of their accountants, one week before settlement the Holdaways registered for GST without informing Mr Ellwood. Relying on Mr Ellwood’s statement that he was not GST registered, the Holdaways subsequently lodged a secondhand goods claim. However, Inland Revenue rejected the GST refund claim on the basis that Mr Ellwood was in fact GST registered, such that the transaction should have been subject to GST at 0%.

The Holdaways claimed damages against Mr Ellwood for the denied GST refund. The District Court initially ruled in favour of Mr Ellwood. However, on Appeal, the High Court overturned the District Court’s decision, requiring Mr Ellwood to compensate the purchasers for an amount equivalent to the value of the denied secondhand goods credit, plus accounting and interest costs.

As a GST registered person, Mr Ellwood should have accounted for GST on the sale of the land. The disclosure by Mr Ellwood comprised a warranty that they were not GST registered, and it was reasonable to anticipate the purchasers might make a secondhand goods claim. Mr Ellwood’s breach of warranty meant the Holdaways did not receive the input credit they anticipated, hence they were worse off than expected. The fact that the Holdaways did not notify the vendor of their change in GST position was not considered to be a valid defence, given the vendor himself was at fault.

The outcome in the High Court aligns with the “common sense” outcome and is a warning for both parties to ensure they complete S&P agreements correctly.

Residential bright line

The Income Tax Act 2007 has long contained provisions to tax the sale of property (or other assets) acquired with the intention of disposal. However, 'intention' is a subjective concept and has been difficult for Inland Revenue to police. Hence, the brightline test, (section CB 6A) was introduced as a means to tax profits made on property purchased and sold within a short space of time. It has been in effect for a few years and it is now worth revisiting how it works.

The brightline test applies to land for which a person first acquired an interest in, on or after 1 October 2015. Typically, a person acquires an interest in land when a Sale and Purchase Agreement (S&P) is executed. This is important because if this occurred before 1 October 2015, the brightline test does not apply. When the brightline test was first introduced it applied if the period between the change of title to the purchaser and the date they subsequently entered into a S&P to sell, was less than 2 years. If the change in title was not registered, it is measured from the date the person first acquires an interest in the land (e.g. the date of the S&P).

When the current coalition government took office, the 2 year period was extended to 5 years. The extended 5 year period applies if the owner first acquired an interest in the land on or after 29 March 2018. Again, this is important because the shorter period of 2 years applies if a person acquired their interest in their land between 1 October 2015 and 28 March 2018.

The provision captures a broad array of residential land, including land with a consent to erect a dwelling, and bare land zoned for residential purposes. However, the provision does not apply to the 'main home', farmland, and property used predominantly as business premises. Properties acquired by way of inheritance are exempt, while roll-over relief applies to transfers under a relationship property settlement.

In most cases, people will apply the 'main home' exemption. To do so the person must have lived in it for most of the period of ownership. If the house is in a trust, the main home exemption is basically only available if a beneficiary and the trust's principal settlor lived in it. The main home exclusion can only be used twice in the two-year period prior to a disposal and cannot be used if a person has a regular pattern of buying and selling residential land.

Because the section has been drafted narrowly, it can apply unfairly. For example, if an investment property owned by an individual for 20 years is transferred to their family trust on 30 March 2018. For brightline purposes, 30 March 2018 becomes the acquisition date to the trust and a sale within 5 years will be taxable, even though 'the family' has owned it for over 20 years.

The brightline provisions are straightforward at first glance, but the devil is in the detail and deciphering the exemptions and timing requirements can be complex.

Snippets

US tax rules

You may think New Zealand's tax rules are difficult to follow. The following unusual, yet permitted, deductions in the US may change your mind.

A man in the US was prescribed regular swimming to treat his arthritis, and so had a swimming pool installed on his property. The associated expenses were subsequently approved by the IRS as tax deductible medical expenses! A similar US provision allowed a tax deduction for the cost of a clarinet and lessons, on the basis of an orthodontist's recommendation that playing the instrument would help correct a child's overbite.

An American TV personality once claimed the cost of formal dresses in her tax return. Although initially declined by the IRS, they were permitted as a legitimate business expense once she explained the dresses could only be worn on TV, and not for other personal use, because they were so tight, she couldn't sit down!

But don't think that means everything is deductible. The cost of lettuce and tomato were denied as a medical expense for a diabetic on a restricted diet, as were the cost of bath oils for a taxpayer suffering from dry skin.

GST on low value imported goods

GST is intended to be a broad-based tax applying to goods and services consumed in NZ, however under the current system not all goods and services are captured. Specifically, GST is not currently collected on imported goods worth $400 or less. Historically, it was thought that the administrative cost of collection would outweigh the tax revenue collected, however the import market has grown giving rise to increasing concern NZ suppliers are disadvantaged in comparison to offshore suppliers.

Following in the footsteps of recent Australian law changes, a Bill was introduced into Parliament in December 2018, the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters), that seeks to level the playing field.

The Bill, after submissions had been received, is now intended to be effective from 1 December 2019, proposes to apply GST to goods valued at $1,000 or less (excluding tobacco and alcohol) that are delivered to a NZ address from overseas. Offshore suppliers will be required to return NZ GST if their total supplies to NZ exceed $60,000 in a 12-month period.

So, what does this mean for NZ consumers? They will likely have to pay GST on low-value goods imported from overseas, while NZ businesses are now on a more level playing field with their overseas competitors.

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