NEWSLETTER

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INSIDE THIS EDITION

Provisional tax improvements

New legislation enacted in February substantially simplifies obligations under the provisional tax regime.

Most taxpayers pay their provisional tax at three times through the course of their financial year, being the 28th day of the 5th, 9th and 13th months after their balance date.

The 'standard uplift' method determines a person's liability based on a prior year's tax payable (105% for last year, or 110% for previous). The problem is that if a person's final liability is more than the estimate, Inland Revenue will charge use-of-money interest (UOMI) on the difference (currently 8.27%).

This is a source of frustration as taxpayers are either rewarded for having a great year by being charged interest by IRD, or they have to scrutinise their own tax position as they trade through the year and make increased payments to IRD when they could be focusing on their business.

In a positive change, the UOMI rules are being amended from the 2017/ 2018 income year. UOMI will no longer be charged from the first two provisional tax dates on the difference between a person's 'standard uplift' liability and their actual liability based on their completed tax return.

In order to defer the start of the interest charge the taxpayer must meet the minimum payment obligations under the standard uplift method on the first two instalment dates. Where the taxpayer does not make the required payments, UOMI will apply on the first two instalment dates based on the lower of the difference between: the amount due under standard uplift and the actual payment; or one-third of the residual income tax liability for the year and the actual payment.

To be eligible for the concession, companies within a group will all be required to use either the standard uplift or GST ratio method for calculating provisional tax. This rule is designed to prevent related entities gaming the differences between the standard uplift and estimation methods to reduce exposure to UOMI.

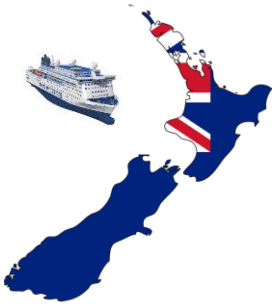
In a similarly positive change, the existing concession, which defers UOMI for individuals with a tax liability of less than $50,000 to their terminal tax date (typically the following 7 February or 7 April), is being increased and widened. From the 2017/ 2018 income year, the concession is being increased to $60,000 and extended to all types of taxpayers, such as companies.

As with the first change above, there are requirements that need to be met in order for the concession to apply, such as meeting obligations under the standard uplift method. IRD expects that the change to the safe harbour threshold will eliminate UOMI charges for approximately 67,000 taxpayers, at least 63,000 of these being non-individuals who did not previously qualify for the concession.

Finally, the late penalty regime is also changing. Currently, a 1% late payment penalty is charged the day after tax is due, a further 4% penalty is charged at the end of the first week and a 1% incremental late payment penalty is charged each month thereafter. For most taxpayers the incremental 1% monthly penalty will no longer be charged on GST periods starting from 1 April 2017 or income tax and working for families debts relating to the 2017/ 2018 or later years.

The perils of a PPOA

It is important for individuals to correctly determine their residency status for tax purposes, as a New Zealand tax resident is taxed on their 'worldwide income'.



A person is considered to be a New Zealand resident for tax purposes if they have been physically present in New Zealand for more than 183 days in any 12-month period or if they have a 'permanent place of abode' (PPOA) in New Zealand. A person ceases to be a tax resident if they are physically absent from New Zealand for 325 days in any 12-month period. However, if a person maintains a PPOA throughout the period they are absent from New Zealand, they are still considered a New Zealand tax resident.

A recent Taxation Review Authority decision has highlighted the importance of these residency rules, and in particular, the breadth of a PPOA.

The taxpayer, a sea captain, had an interest in his employer's superannuation fund, and in foreign investment unit trusts owned by him, which were all sold by August 2008.

The taxpayer was accused by Inland Revenue (IRD) of maintaining a PPOA in the income tax years ended 31 March 2005 to 31 March 2009 (inclusive), and was therefore liable to pay New Zealand income tax on his interest in the unit trusts and any deemed income under the Foreign Investment Fund (FIF) rules.

The taxpayer had been a mariner all his adult life, and under the terms of his employment, spent approximately eight months a year at sea. The taxpayer's wife typically accompanied him at sea. In 1998 he became a trustee and beneficiary of a trust which owned a property in New Zealand. The taxpayer returned to this house at least twice a year in the years from 1998 until October 2014, when the property was sold. The TRA found this property to be a PPOA for the taxpayer, supported by the following facts:

- The property was not rented when the taxpayer was absent from New Zealand - friends and family were able to stay on occasion but otherwise the property was available for use by the taxpayer and his wife.
- During the tax years in dispute, the taxpayer, on average, spent three and a half months in New Zealand, with credit card statements for these periods showing daily use in the suburb where the property is situated.
- The taxpayer's salary was used to meet the trust's loan obligations, pay insurances, utilities and other expenses.
- Vehicles belonging to the taxpayer, his wife, and the trust were registered to the property during the years in dispute.
- A SKY subscription was maintained for the taxpayer's use when at the property.
- The address was used for mail, including mail related to the trust's rental properties.
- When not at sea, the taxpayer's payslips were sent to the property.
- The taxpayer was registered on the Electoral Roll in 2008 at this address.

As a result, the TRA upheld the Commissioner's reassessments for each of the 2005-2009 income tax years, to tax the taxpayer's interest in the unit trusts and any deemed FIF income from the superannuation fund. Adding to the cost, a shortfall penalty for taking an unacceptable tax position was charged, calculated at 10% of the tax shortfall.

Farm House Expenses Deductibility

The Inland Revenue's March 2017 interpretation Statement IS 17/02 'Income Tax – Deductibility of Farmhouse Expenses' alters the deductibility of farm house expenses.

Prior to the release of the interpretation statement, the Commissioner permitted full-time farmers to claim full deductions on dwelling rates and mortgage interest and to also claim 25% of farm house expenses.

Under the new rules, the deduction on farm house expenses has reduced from 25% to 20%.

The deductibility of the dwelling's rates and mortgage interest now depends on the value of the farm house relative to the total farm. If the value of the house is less than 20% of the total farm value, 100% of the rates and interest may be claimed.

If it is greater than 20%, the farm owner is required to do a use of home office claim. The deductibility of the home telephone rental is now reduced to 50%, unless a higher business use portion can be warranted.

These rules apply from the commencement of the taxpayer's 2017-2018 income year. Previously, the Inland Revenue had generally accepted that a full-time farmer could claim 100% of dwelling interest, rates and telephone rental, and 25% of the farm house expenses.

Extract from Farm Accounting NZ vol 106 – Busing Russell.

This is a change that is likely to add compliance costs and affect the expenses claimed also for GST. Please contact us here for greater clarification.

Taxation of insurance receipts

New Zealand has taken a battering in recent years from major disasters including earthquakes, fires, cyclones and floods. These have caused business disruptions, devastated lands, and damaged our capital's infrastructure and homes. Where insurance is received, a question often asked is how these receipts should be treated for tax purposes.

Whether insurance proceeds are taxable will depend on what the proceeds are received for. If proceeds are for items of a revenue nature, such as loss of profits, rents, or reimbursement of business expenses, the proceeds will generally be taxable. Receipts for income protection will also be taxable because they are typically based on loss of earnings and especially if you have been claiming a tax deduction for the premiums.

Insurance proceeds for capital items such as residential properties and loss of land, will generally not be taxable, unless you are in the business of dealing in property.

Depreciable assets - compensation received for depreciable assets is treated as though the asset has been sold to the insurance company for the amount of the compensation received. If the compensation is less than the asset's tax book value (TBV), a loss on disposal can be claimed (for assets other than a building). However, where it is more, tax will need to be paid on any gain made above TBV (i.e. depreciation recovery income is recognised). Any gain above the asset's original cost is a tax free capital gain.

The Canterbury Earthquake - specific provisions were enacted for buildings that were damaged in the Canterbury earthquake. As a starting point, proceeds will always be taxable to the extent of the cost of repairs. This results in a net nil position for income tax purposes. Where proceeds exceed the cost of repairs ("the excess"), the tax treatment will depend on whether the property is deemed "repairable" or "irreparably damaged".

For "repairable" property, the excess is deducted from the property's TBV. If the adjusted TBV is reduced below zero, the negative TBV would ordinarily be taxable depreciable recovery income. This is however, limited to the lesser of the negative TBV and the actual depreciation claimed to date and is taxable in the income year in which the proceeds are applied to reduce the TBV. Any remaining amount will be treated as a capital gain. Conversely, if the excess does not cause the adjusted TBV to become negative, the depreciation recovery income will be deferred until the property is later sold.

A property will be "irreparably damaged" if it has been rendered useless for deriving income and is demolished or abandoned for later demolition. This should be agreed with the insurer and documented in the settlement agreement. The property is treated as sold for the amount of the insurance proceeds, and re-acquired for nil consideration. Any depreciation recovery income can be deferred and offset against a replacement asset that is purchased by the 2018/ 2019 income tax year. The remainder will be a capital gain.

The proceeds of a future sale will be all capital gain, assuming no other taxing provision applies as the property's tax base is nil for depreciation purposes.

Snippets

Nordic tax records

It's often considered taboo to ask other people how much they earn. So what would you do if you could look up how much your colleagues, neighbours and friends make, all legally, online and for free? Well this is what happens in some Nordic countries!

Norway has had an 'open salary policy' since 1863, when they used to publish individual's tax returns and post them to the walls of the local town hall.

This practice continued, and until recently, Norwegians could anonymously request certain information about other taxpayers. The information is limited to the total income earned, and total tax paid by the taxpayer – there is no breakdown of amounts received from different income categories.

This understandably led to several concerns, so when Norway's right-wing government took office in 2013, they addressed these worries by tightening the rules. Now, people still have the right to request tax information about other individuals, however the person whose name is targeted is sent an email telling them who has been checking up on them.

This loss of anonymity has had an immediate and dramatic impact on the amount of searches people have been making, falling from 16.5 million per year to 2.15 million.

Donald Trump is likely to be relieved he doesn't live in Norway….

Beware of paying excessive salaries

It is very common for family owned companies to employ members of the family in the business on a permanent or casual basis. There is no problem with this per se, however income tax rules seek to prevent 'excessive salaries' being paid to family members.

Inland Revenue has recently been focusing on this issue and has been scrutinising the type of work completed, the amount paid, the way in which it was calculated, and what a third party might be paid for the same work.

There is no precise measurement as to what constitutes 'excessive', as each case is different. What is most important is that business owners determine the value of a relatives remuneration based on the service provided to the business. The relative should be paid the same amount as an unrelated employee performing similar duties.

IR has the ability to intervene and reallocate remuneration, income or losses if it considers the amount is not reflective of the value contributed. If an amount is deemed to be excessive, the excess may be recharacterised as a dividend and therefore non-deductible to the payer. Where salaries to family members are paid it is important to ensure the employment and the amount paid is calculated and documented on an arms-length basis.

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