NEWSLETTER

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INSIDE THIS EDITION

From all our team – Aleashia, Betty, Julian, Kathryn, Kathy, Kristina, Lyn, Nicole, Rebecca, Ronnie, Sara, Tala, John & Andrew – wishing you all the very best for Christmas and the New Year!

Thank you for all your personal dealings and business with us in 2019. We look forward to renewing contact with you again in the New Year.

Please note our office closes on Monday, 23 December at 3:00pm and re-opens on Monday 6 January. ***Merry Christmas.***

Ringfencing of Residential Rental Losses

Property investors will no longer be able to deduct their expenses relating to their loss-making residential investment properties from their other income like salaries and wages or business profits.

The changes are now in force with the rules applying from the start of the 2019/2020 income year, which for most of us means from 1 April 2019 – in practice your next tax year.

The typical scenario we all recognise is to use the existing equity in your home to borrow up to 100% of the purchase price of a residential rental property. The ensuing interest charges, together with rates, insurance, and repairs create losses, which then reduce your business income, or the PAYE salary resulting in lower tax or cash refunds. As the mortgage on the rental property begins to reduce, so does the interest charge, where eventually the rental property begins to make a profit. On the basis that the property is owned for at least five years, you usually hope to benefit from a tax-free capital gain.

New section EL4 of the Income Tax Act 2007 provides that you will still be able to claim rental property losses against future rental income from residential properties, though any excess of expenses over income will essentially be ‘ring-fenced’ and they will have to be carried forward to future years. This means that whilst you don’t lose the benefit of those losses for tax purposes, you cannot apply those losses against your other taxable income. This may have a significant effect on cashflow for some property investors, particularly those who need the reduced tax or refunds for maintenance, or to reduce debt. Accordingly, you need to see these new rules largely as a timing deferral for when you can use the losses.

The only difficulty is of course that you need cash now for maintenance, debt reduction, and income tax.

You should also be aware that under the existing definition of residential land, your Gold Coast apartments, and any other residential land you own overseas will also be included in this regime.

The new rules use the same definition of residential land that already exists for the bright-line test. There are a number of exclusions, with the main ones being:

- Your (or your trust's) main home
- Land held on revenue account, that will be taxable due to being acquired for a business relating to land. In some instances, the taxpayer will need to make a notification to Inland Revenue for the exclusion to apply
- A company that is not a 'close company'
- Land that is subject to the mixed-use asset rules (commonly holiday homes) as these already have their own form of ring-fencing
- Property that is provided to employees or workers in connection with their employment or service

The default position is that these rules apply on a 'portfolio' basis. If rental property 1 makes a loss, you will be able to offset that loss with the profit from rental property 2. You do not have to wait until rental property 1 makes a profit before you can use its loss. However, for completeness, if your portfolio of rental properties creates an overall loss for the year, that loss cannot be used to reduce your other taxable income. This portfolio type approach is at least one positive aspect of the new rules.

As always with new legislation, we expect that a few issues will pop up once we work through the detail.

If you have any questions or scenarios that might impact you, please get in touch.

Court case – tax avoidance arrangement

Two recent (connected) cases at the Taxation Review Authority (TRA) demonstrate that unnecessarily complex transactions can raise a red flag for IRD.

Both cases related to a taxpayer referred to as Mr Brown, who acquired a 2/3 interest in a joint venture known as the NPN Partnership (NPN) back in 1981. NPN held several residential property investments, of which a 2/3 share was transferred into one of Mr Brown's family trusts.

Over a period spanning 20 plus years, the income rights to the rental income derived by NPN were sold from one of Mr Brown's family trusts to another on three separate occasions. Although each transaction was slightly different, broadly, on each occasion the trust acquiring the income rights funded the purchase by way of vendor loan, with the interest capitalised and not payable until the expiry of the loan.

Close to the end date of each loan, the trust would sell the income rights to a newly settled family trust for a price equivalent to the outstanding loan with accumulated interest. In effect, each of these sales from trust to trust created a new loan. On each occasion, the new loan gave rise to an interest expense which the trust claimed as tax deductible, offsetting the rental income derived from NPN such that no tax was paid.

The Commissioner contended that the arrangements constituted a tax avoidance arrangement pursuant to BG 1 of the Income Tax Act, and sought to deny the interest deductions whilst reconstructing the income derived by NPN onto Mr Brown. The Commissioner contended that during the time the income rights were held in trust, the rental income was used my Mr Brown for his personal and family expenses. The taxpayer contended that the transactions were all standard commercial transactions, and there was no artificiality in the trusts obtaining the interest deductions.

However, the TRA supported the Commissioner, ruling that the transactions were driven with a tax motive in mind, with no commercial reality, given that the loans resulted in no economic cost to the trusts. The structure was artificial and contrived.

In sentencing, the TRA allowed IRD to impose re-assessments dating back to 2001, as they considered Mr Brown's tax returns to be wilfully misleading. As a further sting in the tail, it was deemed that the Trustees of the family trusts had failed to meet their tax obligations, hence the income was taxable at the 'non-complying trust rate' of 45%.

A good reminder that whilst all taxpayers are entitled to arrange their affairs in a tax efficient manner, tax should not be the main motive for a transaction with no commercial substance.

Generation Z – our future workforce

The rise of Generation Z ('Gen Z') is imminent in today's workforce. Comprised of those born between mid-1990s and early-2000s, Gen Z has grown up in a world with technology at their fingertips. Common traits include: confidence, desire to succeed, thriving on recognition, being adaptable and tech-savvy. However, their most valuable aspect is they represent an organisation's future.

Fast forward 10 years from now – baby boomers will be retired and employers will have no choice but to recruit an increasing number of Gen Z employees. As Gen Z members are currently young, they are perhaps not a priority when it comes to recruitment planning. However, it is crucial employers learn to understand this generation and how to attract, recruit and retain them.

If Gen Z members are not being challenged, recognised or rewarded for their efforts, they will have no hesitation to search for opportunity elsewhere. Today, it is increasingly common for employees to change jobs after spending only months with their employer. It is clear that the fierce, unparalleled loyalty that was once displayed by previous generations will not be as prevalent in the future. Being adaptable and tech savvy also means Gen Z will demand remote working and flexible working – such "perks" will become expected, rather than incentives.

To attract Gen Z into their organisations, employers should be aware that the approach to job searching is significantly different to the traditional methods. Often, Gen Z begin their job search on the organisation's website – looking for the organisation's culture to impress them. They then head to social media to learn more. Hence, organisations need to get creative with different social platforms and use them to reach out to potential candidates.

Organisations should also assess whether existing recruitment processes remain appropriate. For example, it is currently commonplace for psychometric testing, essay writing, and even written case studies to be requested before interview stage. An absence of face-to-face communication can make Gen Z candidates feel like just a number. Understandably, this lack of human interaction does not initiate feelings of loyalty. Extensive recruitment processes can also dissuade Gen Z workers from applying at all, meaning employers are missing out on potential candidates. To combat this, organisations should prioritise the key aspects of the recruitment process and eliminate any unnecessary stages.

Ultimately, whether an organisation can tailor their recruitment plan for Gen Z will depend on its individual circumstances. Nonetheless, it is important for employers to understand this generation and how to best attract, recruit and retain them.

AML/CFT Anti-Money Laundering and Countering Financing of Terrorism Act 2009

As alerted to in an earlier newsletter, following legislation that came into effect last year, we may be required to undertake client due diligence in order to comply with our obligations under the revised Anti-Money Laundering and Countering Financing of Terrorism regulations in New Zealand.

The information we may require (if any) will depend on the type of work we're delivering and your type of entity. If required, we will need this information before we perform any work.

We will let you know if we need to carry out due diligence and, if so, what information we need. This may include:

- Forms of photo identification (for example your passport or driver's licence)
- Proof of your address (for example a recent utility bill or rates invoice)

- Your occupation and where you do business
- Whether you reside in a high-risk jurisdiction
- Whether you are a politically exposed person (PEP)

We may need further information depending on your specific services. For example, for trusts, we may require information about trustees and beneficiaries. For companies, we may need information about directors and shareholders. We may also need to verify the source of funds for certain transactions.

We will be in touch with those of you affected over the comping year and thank you in advance for your cooperation.

Snippets

Wacky business ideas

Ever dreamt of being your own boss? Well, millions of people have turned that dream into a reality and some even claim it's easy! Recent studies conducted by the Global Entrepreneurship Monitor reveal that 40% of respondents thought starting a business was easy and 46% thought there were plenty of opportunities to start a business. Based on some of the strange, yet successful, business ideas out there, they might just be right.

Have you ever had the urge to send someone a message on a potato? Well now you can! Potato Parcel lets you send a potato with a personalised message written on it. They've already sold over 70,000 potatoes! If gifting a vegetable isn't quite your style, perhaps a pet rock is more appropriate? Entrepreneur Gary Dahl launched the Pet Rock back in the 1970s and despite the craze only lasting about six months, it was still enough to make Dahl a millionaire.

Another common sector for new businesses is the fitness industry. New exercise fads are constantly emerging; one of the more unusual ideas are "rage rooms". Originating in Tokyo, the rooms are designed to provide patrons with a chance to hurl cups or plates against concrete slabs in an effort to relieve stress. Today, they've spread all over the world with more than 100 scattered across the USA alone.

So, get your thinking cap on, the more unusual the idea, the better!

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

Times are changing – Demise of Cheques

Developments in electronic payment methods and improved ease of online payments from your smartphone or tablet, means use of cheques continued to decline.

Although a significant amount of people continue to use cheques, IRD, and ACC (as well as Kiwibank) have announced that from March 2020 they will no longer accept payment by cheque; other than in rare circumstances.

Besides internet banking, both IRD and ACC accept payment by debit/credit card over the phone, via direct debits, and cash or eftpos payments at Westpac Bank branches. In addition, IRD payments can be made through MyIR, and for ACC through your MyACC for Business accounts. Doing away with cheques will impact a range of taxpayers/businesses; however, it is a reflection of the digital world we live in today and a definitive move away from the paper-based era of payments.

On the positive side, there is less likelihood of late payments and associated penalties if paying direct as opposed to relying on posted mail these days.