FLUKER DENTON LIMITED
Chartered Accountants

NEWSLETTER

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INSIDE THIS EDITION

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Government tax changes to address housing demand

To address the issue of housing affordability the Government recently passed into law several tax changes, including disallowing interest deductions on residential investment property and extending the bright line test to 10 years. The change to interest deductions was referred to as closing a loophole, notwithstanding being able to deduct expenditure incurred to derive taxable income is a fundamental and basic feature of New Zealand's tax system.

Interest deductibility - Under the new rules, interest payments on residential rental properties acquired on or after 27 March 2021 will no longer be deductible. For properties acquired before 27 March 2021, the ability to claim interest will be progressively phased out over four income years starting from 1 October 2021 (i.e. by 25% each year until the 2025-26 income year).

Of significance however is that an exemption is to be introduced allowing interest to continue to be deducted on loans taken out to purchase new builds. Inland Revenue is to undertake consultation on how a "new build" should be defined.

Bright line changes - The previous bright line test taxes the sale of residential property sold within five years, subject to specific exclusions such as for the family home and farmland. Going forward, a residential property acquired on or after 27 March 2021 will be subject to a 10-year bright line test, i.e., if it is disposed within 10 years of acquisition (generally the date a binding sale and purchase agreement is entered into) any capital gain will be subject to income tax.

However, similar to the interest exemption for new builds outlined above, the previous bright line period of five-years will continue to apply to new builds.

The exclusion for the "main home" is also being modified. Under the old rules it applied on an all or nothing basis, i.e., if the property was "predominantly" a main home it was not taxable on sale. This exclusion is also being amended. For property acquired from 27 March 2021, if the “main home” is not used as the owner’s main home for more than 12 months at a time during the bright-line period, the profit on sale will be partly taxable based on the period it was not a “main home”. If the property was purchased before 27 March 2021 the main home exclusion continues to apply on an all or nothing basis.

Over recent years a number of changes to the taxation of residential property have been made that did not appear to slow house price inflation, such as rental losses being ring fenced, depreciation deductions being denied, the bright line test being first introduced and then being extended to five years. But this is the first time a distinction has been created within the residential market itself by treating new builds differently. This could prove to fuel the price of new houses even more, particularly if the underlying issue of increasing supply has not been addressed.

The New 39% Tax Rate

The top personal tax rate on individual income over $180,000 has now passed into law effective 1 April 2021 (for the 2022 tax year). Depending on future governments, this new rate may form part of our progressive tax system for many years ahead, as New Zealand attempts to finance the COVID-19 related economic recovery.

The last such tax change was in 2010 when the top rate then of 38% was reduced to 33% for income over $70,000 where it has remained in the intervening years. The “tax issue” now is that the new 39% rate diverges from the Trust tax rate of 33% and we would expect, naturally, to see tidying of taxpayers’ affairs and structures where possible. For example, where we could and where the shares are largely held by individuals, we have been advising Companies to distribute retained earnings as dividends prior to 31 March 2021, thus allowing tax still to be paid at 33% rather than from April at 39% for those individuals affected by the new rate. This is legitimate practice and not tax avoidance?

However, we note that Inland Revenue have seized on the realisation that restructuring for tax reasons may once again appear attractive, and they have issued clear warnings that such activity will be closely looked at. The main areas at issue that have been well established by court cases and tax rules since the last round of tax rate divergence from 1999 include:

- The Penny & Hooper case concerning surgeons who used family trusts and companies to pay themselves artificially low salaries, streaming the excess income through their entities and out, to be taxed at ultimately, lower tax rates. Essentially for personal services income generated by professionals in the main, there is now an established notion that a ***fair market salary*** must be paid such as to tax the original income in the hands of the individuals generating it.
- Specific anti avoidance rules “the attribution rules” which work already to prevent individuals providing personal services, interposing an entity, say a Company, between themselves and the party they are doing work for. This can look attractive when viewing the corporate tax rate of 28% being now much less than the new 39% top personal rate. However, the rules in anti-avoidance situations work to ensure the income is streamed out to the individual and taxed at their marginal tax rates.

We note these areas already then have application, and have been part of the well understood landscape in recent years. Where there may now be a restructuring desired, that would have to be very carefully looked at to ensure any anti avoidance risks are understood.

Apart from the direct tax effect on individual income for some clients, the 39% new rate spins off also into other tax areas which include as examples:

- Fringe Benefit Tax – with the new 39% tax rate, the FBT rates will also increase and whereas in the past the single use FBT rate of 49.25% has been widely used for simplicity, the alternate rate method whilst having more complexity and taking more time, should now be explored as an option to save FBT cost. Otherwise, employers may end paying FBT as if all their employees were earning more than $180,000 when in reality that new 39% rate applies to only 2% of New Zealanders.
- Resident Withholding Tax new higher rate of 39% from 1 October 2021.
- Employer’s Superannuation Contribution Tax (ESCT) will rise to 39%.

Importantly to note for many clients with Trusts, is that there will also be significant new disclosure requirements when filing 2022-year Trust income tax returns. These requirements are to be used by the Revenue to assess compliance with the 39% rate vis a vis use of structures and entities by Trustees. These happy (not) changes are outlined in the following Newsletter item.

New Trust Tax Disclosure Rules

In December 2020 the legislation enacting the new 39% tax rate was passed. Within the same bill, somewhat overshadowed by the rate change, was the introduction of a new "annual return" requirement for trusts.

Not to be confused with the new Trusts Act that came into effect at the end of January which requires certain disclosures to be made to beneficiaries, the significant annual return requirement included in the December 2020 bill imposes the disclosure of additional trust information to Inland Revenue on an annual basis.

As enacted, the annual return for trusts will comprise:

- an income statement and balance sheet;
- details of any settlements made on the trust during the year;
- the name, date of birth, country of tax residence and IRD number of any person who makes a settlement on the trust in the year, whose details have not previously been provided;
- details on every distribution made by the trust during the year, including capital distributions, as well as details on the recipient beneficiaries; and
- details of any person who has the power to appoint and remove trustees and beneficiaries of a trust.

The requirement will not apply to non-active, charitable or Maori authority trusts and foreign trusts that are already filing disclosures with Inland Revenue.

Although the legislation applies for the 2022 income year onward, there is a provision which allows Inland Revenue to request the same annual return information for any period between the 2015 and 2021 income years.

Inland Revenue is likely to use the information to monitor the extent to which income is being taxed to trusts at 33%, that would have been taxed at 39% if derived by individuals. That information could then be used as a basis for the Government to either increase the trust tax rate or increase the extent that beneficiary distributions are taxed to individuals.

The information could also be used by Inland Revenue to specifically check other areas of compliance. For example:

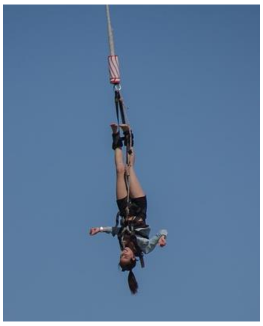
- Imputation streaming rules require dividends received by a trust that are then distributed to a trust's beneficiaries to be spread proportionately across those beneficiaries, otherwise imputation credits may be forfeited.
- Taxable income can be triggered if a trust receives the benefit of a debt forgiveness and a subsequent distribution is made to a corporate beneficiary.
- Application of the land taxing rules can depend on whether parties are associated. The level of disclosure will enable Inland Revenue to readily determine who a trust is associated to.

As time passes and the amount of information held by Inland Revenue increases, they could proactively identify errors in a trust's tax position.

The new trust tax disclosure rules coupled with the new Trusts Act regime, mean that compliance costs of using a trust are increasing significantly and the purpose and benefit of new or existing trusts should be carefully evaluated.

Employment recovery

Over a year on from NZ's level four lockdown, businesses and communities alike have experienced their fair share of highs and lows. Many have had to rapidly adapt to the Covid-19 induced restrictions. For some, they have benefited from unpredictable productivity gains, meanwhile others have struggled to regain pre-pandemic momentum. Employment levels slumped to an eight year low in September 2020, with over 150,000 unemployed people. So nearly six months on, how does the job market stack up now?



Statistics released by Seek NZ reveal that March 2021 saw the highest number of jobs ever advertised on the site. Listings for jobs were up 11% on the prior month and up 55% on March 2020. Every region in NZ saw listings increase, with Bay of Plenty, Otago and the West Coast experiencing the largest growth (22%).

Perhaps in response to the expectation of a NZ / AU travel bubble, hospitality and tourism showed one of the most significant increases, with listings up 32% compared with February. Retail and consumer products followed closely behind with a 29% increase.

Trade Me Jobs paints a similar picture with over 70k jobs listed for the quarter ending 31 March 2021, representing a 22% increase in Q1 compared to prior year. The sectors with the largest year-on-year increase were automotive (50%), construction and roading (43%), and manufacturing and operations (40%). Although prior year figures may show signs of the economic uncertainty first felt from Covid-19, the Q1 figures for 2021 still exceed those of Q1 of 2019 (up 15%) and Q4 of 2020 (29%).

Interestingly, despite the increase in job listings, Seek NZ data shows that applications per job are actually down.

With an abundance of listings, job hopefuls should feel optimistic that their career or job search is looking up.

However, employers may be feeling the pressure to find the right fit. It is not uncommon for hiring managers to have post hire regrets when they find their new hire is not fit for the role, and this inevitably comes at a cost.

New Zealand employers have cited increased stress on colleagues, increased workload for existing team members and increased stress on managers as the three top consequences of a bad hire. However, the ripple effect does not stop there with lost productivity, higher recruitment costs and low staff morale also arising as a result of recruiting the wrong person.

Despite the above, the current state of the job market shows positive signs for NZ's ongoing recovery in response to Covid-19. A resurgence in listings for hospitality and tourism provides a spark of optimism for a sector which has been hit particularly hard.

Snippets

Supply shortages

COVID-19 has fundamentally disrupted global trade to the point there are a number of product shortages starting to play out, and in some cases of some surprising items:

- The shipping containers themselves: With only two makers of shipping containers globally and containers being trapped in the congestion at ports, there is now a shortage of containers, let alone the products that fill them.
- Toilet paper: At this stage, most people are aware of the high demand for toilet paper – with countless people stockpiling and panic-buying rolls to ensure that they don't run out during a lockdown. However, the risk now exists that manufacturers will run low on wood pulp due to the container shortage.
- Marmite: The popular but polarizing spread has also been in short-supply due to a lack of brewer's yeast amidst pub closures.
- Ketchup packets: The US is facing a shortage of ketchup packets because of the increased demand due to the change from dine-in to takeaway and delivery.

Garden Gnomes: Left with few leisurely options available in lockdown, people have resorted to gardening as a source of entertainment. This boom in demand, coupled with a shortage of raw materials due to the Suez Canal incident, has seen the humble garden gnome become a hot commodity.

Pink collar crimes

We have all heard about white collar crimes, where financially motivated nonviolent crimes such as embezzlement are committed by business people. However, pink collar crimes, is a term coined to refer to usually female office workers in low-to mid-level positions who steal money from their employers, have been on the increase.

One of the largest instances was in Singapore where an accounts clerk embezzled more than $46 million over 7 years by depositing business cheques into a personal account used to fuel a gambling habit.

In New Zealand, a McDonalds Manager stole $166,000 as she was able to authorise cash refunds to customers. It was not until an internal audit disclosed the disproportionally high amount of refunds paid out when the particular manager was on duty, that she was apprehended. Further examples include an accounts clerk paying herself just under $90,000 in wages in a 12-week period and a casino worker stealing $45,000 in gambling tokens in the space of one month.

Does this mean that the diligent accounts clerk, bookkeeper or manager may not be as innocent as we all think? Well potentially. Companies continue to invest large amounts of money into anti-fraud systems and in some cases even have teams in place to detect such occurrences. So how does this go unnoticed? Usually through a combination of opportunity (weak systems and lack of review…), motivation (gambling addiction/greed…), and cleverness. Of course, human nature is to trust each other, but being proactive in review is a good deterrent. A couple of hundred dollars here and there can be harder to spot, but eventually adds up.

Along with high-tech software detection systems, do not forget to just look out the window and ask yourself, how does your employee afford the insurance on her Ferrari?

IRD Real Estate Sector Campaign – Watch Expenses

Inland Revenue are looking closely at real estate salespersons/agent customer groups this year. They have identified, in their words, that these groups are claiming a high level of expenses relative to their income.

IRD are suggesting that some of these taxpayers are claiming private expenses and are not keeping vehicle logbooks or retaining other business records to support a deduction.

Whether this is so, or not, has to be tested, but it is opportune to remind everyone (all clients) to have good records to support expenses claimed. If you happen to be investigated and your tax returns are reviewed, records will likely have to be provided to IRD to justify the expenses claimed in the return.

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