Welcome to Tax Watch, our round-up of New Zealand tax developments affecting your business.

This month we take a look at the long overdue changes to the Customs & Excise Act 1996, the first major overhaul of that Act in twenty years. The proposed changes have been fast tracked, and could become law as early as the beginning of 2017.

The government’s latest tax bill introduces proposals concerning non-resident withholding tax (NRWT) and approved issuer levy (AIL), closely held companies, GST, related party debt remission, and loss grouping and imputation credits. We encourage all affected businesses to get in touch.

In other news:
► Two landmark Supreme Court decisions shake up trust law, and
► Inland Revenue proposes to change its approach to donee organisations, which could be bad news for many charities

In a personal reflection, David Haywood discusses the case for a cut in the company tax rate to be added to the current tax debate.

Faster Tax Watch Alerts ahead

It’s becoming ever more important to keep on top of developments in real time. We’re planning to issue more frequent brief Tax Watch Alerts to supplement our regular updates. Let us know your preferred approach.

Tax Watch in brief rounds out other recent developments, canvassing various items released by Inland Revenue including reduced mileage rates applying from 1 April 2016.
The new Customs & Excise Act

This is a once in fifty year event. Overall Customs has missed the mark. Businesses are left with a smorgasbord of changes which are hard to navigate and difficult to assess.

Bill to be introduced soon

The Customs & Excise Act 1996 has been subject to an overhaul. This review has been long overdue as the legislation has clearly become outdated.

Recently the proposed changes received Cabinet approval and the changes are being fast tracked with a new Act that could be in place by early 2017.

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We look at the highs and lows of the changes that have been approved by Cabinet.

Information sharing will continue to protect confidentiality

Customs handles a lot of information about cross border travellers and cross border trade. Approximately a third of all the decisions made by Cabinet as part of this review are in respect of information sharing.

What is reassuring for business is Customs’ commitment to ensuring confidentiality of commercially sensitive information. Customs is also looking to access and share information to boost the use of preferential rates of duty under Free Trade Agreements. What is not so good for businesses is the sharing of information with Inland Revenue and overseas customs authorities.

Greater powers to intercept illicit goods

There is little that will be of direct relevance to most businesses. The changes are principally designed to help Customs intercept illicit goods and dangerous persons. Business travellers should be aware of Customs’ broad powers to inspect accompanying luggage and digital devices.

Interest and late payment penalties to replace additional duty

Customs is looking to scrap the draconian additional duty regime whereby additional duty compounds for excise tax payers who short pay. Instead Customs is exploring a system similar to Inland Revenue whereby penalties apply to late payment and interest is charged for underpayments of all forms of duty. It will be controversial if Customs decides to impose interest on GST errors for importers who are registered for GST and can claim back GST from Inland Revenue (i.e., where there is no loss of revenue to the Government).

Customs brokers face a raft of changes to the administrative penalties regime, including the extension of administrative penalties to export entries. Businesses should be aware of their contractual responsibilities with their customs brokers in relation to administrative penalties.

Excise tax fails to deliver bonded warehouse regime

Wineries will be breathing a sigh of relief that they haven’t lost their offsite storage concessions. Brewers will be raising a glass as the concession will be extended to all domestic alcohol manufacturers.

We are disappointed that Customs have rejected the introduction of a bonded warehouse regime for imports and domestic manufacture of excise goods.
The good news is the introduction of a binding ruling system on valuation and a formal mechanism for dealing with transfer pricing adjustments.

It claims this could be reversion to a pre-GST sales tax regime, but ignores the economic benefits. Many countries with a GST system operate a bonded warehouse regime.

New domestic producers will be also be disappointed that they will be forced to file and pay monthly until such time that Customs are satisfied that this compliance burden can be lifted.

No GST simplification

Much to the frustration of GST registered importers, GST will still be treated as a duty and Customs will continue to collect GST as such. Practically this means that there will be no simplification in the short and possibly medium term. Customs will continue their audit activity where there is only GST at stake and the GST is recoverable from Inland Revenue.

There is a promise that work will be done in this area.

Progress on valuation and transfer pricing problems

The good news is the introduction of a binding ruling system on valuation and a formal mechanism for dealing with transfer pricing adjustments and other adjustments to the customs value of imported goods.

However, extreme caution is required when approaching Customs on valuation matters. Recent case law highlights the problems that can be encountered when seeking clearance from Customs on valuation matters.

Retailers to miss out

Brick and mortar retailers are out of luck. The low value threshold for imported goods is out of scope for this review.

Separate consideration of the low value threshold appears to be continually delayed as Customs try to grapple with solutions, and no doubt technology, for this thorny issue.

Approach to the new Act

We are pleased that Customs is taking a purposive approach to the new Act. This should help provide greater certainty for businesses. We also like it that the Comptroller of Customs will have statutory discretion concerning the collection of revenue and that a new disputes resolution process is being put in place.

This should bode well for future administration of revenue collection by Customs; particularly given a significant portion of GST revenue collected by Customs is simply refunded by Inland Revenue. Customs’ Comptroller, Carolyn Tremain, formerly headed Inland Revenue’s Service Delivery arm, so should understand current problems from both sides.

However, the success of the new Act will ultimately depend on how well the changes are embraced by Customs at an operational level.

If you wish to discuss the review of the Customs and Excise Tax Act, please contact us.

Paul Smith
Partner
Indirect Tax Leader
Paul.smith@nz.ey.com
Tel: +64 274 899 866
The discussion document does not explain how the two proposals would be administered. It also neglects to address the additional compliance costs that would be borne by taxpayers.

Parliament to call for submissions

The Taxation (Annual Rates for 2016-2017, Closely Held Companies and Remedial Matters) Bill 2016 contains the biggest suite of tax technical measures for several years.

Now is the time for you to have your say on the proposals. Parliament’s Finance and Expenditure Committee has called for feedback by 29 July 2016.

The main proposals include:

► Tougher rules around the taxation of interest paid to non-residents
► Simplification for closely held companies
► A tidy-up for GST rules
► Relief for related party debt remission, and
► Loss grouping and imputation credit reforms

The bill contains many other policy and remedial amendments.

Tougher rules around the taxation of interest paid to non-residents

The proposed changes will widen the Non-resident Withholding Tax (NRWT) net. They aim to:

► Better align the NRWT liability with the income tax deduction available to the borrower for that interest, and
► Expand the range of debts treated as being from a related party and therefore subject to NRWT at 10 or 15 percent rather than Approved Issuer Levy (AIL) at 2 percent

The government also proposes to restrict the ability for borrowers to access the AIL regime. It claims that Inland Revenue is unable to police the current law.

The proposals are wide ranging and complex. You should consider their potential impact on your financing structures.

These changes follow on from the Issues Paper released by Inland Revenue in May 2015.

Simplification for closely held companies

Most New Zealand businesses are closely held. Many have elected to be treated as ‘look through’ companies for tax purposes, but the look through rules are complex. The Bill proposes changes to aspects of the rules, such as eligibility criteria, deduction limitation rules, debt remission, entry tax and continuity of ownership provisions.

The Bill is intended to enhance consistency between an individual operating a business and a closely held company. As Revenue Minister Michael Woodhouse explains:

“While closely held companies typically have just a few shareholders, they are also a significant proportion of the total number of companies in New Zealand. It is important that the tax rules apply as intended and that the decision to convert a small business to a company is not driven by tax considerations.”

Tax Watch, Edition 4, June 2016
The Bill proposes allowing transfers of imputation credits between commonly owned companies which should allow fully imputed dividends to be issued.

Tidy-up for GST rules

Following September 2015’s GST Issues Paper, amendments will include:

► A company will be able to deduct the cost of raising capital if the funds are used in an activity of making taxable supplies

► A company that makes taxable and exempt supplies will be able to propose an alternative method to apportionment of the supplies

► An input tax will be claimable for gold, silver or platinum purchased from an unregistered person for sale to the public by a registered person, and

► Services provided in connection with land which intend to change the physical or legal nature of the land will be zero rated

Loss grouping and imputation credit reforms

Under the current rules, a commonly owned group of companies can offset losses and profits to arrive at a net tax liability (loss grouping). However this reduces the amount of imputation credits created for that group of companies. A group of companies can be wholly owned (100% commonality) or commonly owned (66% or more). The treatment of dividends and imputation credits differ for the different categories, which results in commonly owned companies having a comparative disadvantage compared to wholly owned companies.

The Bill proposes allowing transfers of imputation credits between commonly owned companies which should allow fully imputed dividends to be issued.

Relief for related party debt remission

The government has – at last – confirmed that forgiving debt owing to shareholders (debt remission) or converting that debt to equity (debt capitalisation) will not create taxable income.

We’ve talked about this saga several times before, most recently in September 2015’s Tax Watch. An Inland Revenue ruling, in our view misinterpreting existing law, claimed that the standard commercial approach to debt capitalisation could be seen as tax avoidance.

As a result, the government is pursuing a law change to effectively overrule Inland Revenue’s interpretation. The new rules should ensure debt remission income does not arise where the remission causes no change in the net wealth of the economic group or dilution of ownership.

This change will be backdated to the 2006/2007 income year to provide certainty.

Other policy or remedial amendments

This wide-ranging bill also includes proposals covering:

► Aircraft overhaul expenses

► Land tainting and council controlled organisations

► The relationship between the general anti-avoidance rule and double tax agreements

► Information sharing agreements between government departments

► Applying the time bar to ancillary taxes such as PAYE, fringe benefit tax, resident withholding tax, NRWT and to AIL

► Life insurance, and

► Taxable bonus issues

Make your voice heard

If you’ve got a view on any of these changes, then we recommend making that known in writing to the Finance and Expenditure Committee. The Committee takes submissions seriously and change is possible. Every tax bill we’ve submitted on has changed between introduction and enactment, usually for the better.

We’d love to talk about your point of view.

David Snell,
Executive Director, Tax
David.snell@nz.ey.com,
Tel: +64 21 845 361
Vulnerable Trusts

Supreme Court’s new take on trusts and relationship property

Two recent Supreme Court decisions in Clayton v Clayton (Vaughan Road Property Trust)\(^1\) and Clayton v Clayton (Claymark Trust)\(^2\) have demonstrated the risks faced by settlors and trustees of trusts. They have changed the law.

Trusts are used to protect assets against claims by creditors of all kinds as well as in matrimonial property matters.

It is common for settlors who established a trust to also be the trustees and/or beneficiaries of that trust, and retain various powers to control the trust property. However there is a fine balance between the settlor:

- Retaining too much power and control over the trust property (as settlor, trustee, appointor, protector, principal family member or any combination of those), and
- Retaining too little power and control, which limits the settlor’s ability to supervise the administration of that trust property.

Too much power retained

Clayton v Clayton (Vaughan Road Property Trust) outlines that where the settlor has retained too much power, the trust property may be exposed to claims from ex-partners of the settlors that the trust property constitutes ‘relationship property’ in terms of the Property (Relationships) Act 1976 and, as such, ought to be shared equally. There is an expectation that the same argument will be explored in relation to claims made by the settlors’ creditors.

Nuptial settlements cast a wide net

Clayton v Clayton (Claymark Trust) relates to the application of section 182 of the Family Proceedings Act 1980, which gives the court discretion to inquire into any ‘nuptial’ settlement and make any order it thinks fit.

The Supreme Court held that a generous approach must be taken when considering whether there is a nuptial settlement, overturning previous judgments which focused on the intentions of the parties at the time the settlement was made.

The Supreme Court noted that the following trusts may be regarded as nuptial settlements, setting a very wide net indeed:

- Trusts set up before marriage when no particular spouse is in contemplation (could become nuptial if marriage is entered into later)
- Trusts from which others will benefit (the fact that others may benefit is irrelevant)
- Trusts for business purposes (nature of assets/purpose of trust is irrelevant), and
- Trusts set up by third parties, in particular by parents for the benefit of their adult children who are or might become married.

The Supreme Court’s decision firmly offers section 182 of the Family Proceedings Act 1980 as a powerful tool for attacking trusts, in addition to the tools available under the Property (Relationships) Act 1976.

Our team at EY Law has experience in advising on trust matters and can offer comfort that your trust is not vulnerable, suggest appropriate amendments to your trust or assist you with drafting a trust tailored for your purposes, ensuring the aforementioned risks are minimised to the extent possible. We can also work with your existing legal advisors, for instance by offering a peer review of your trust documentation, should this be appropriate.

Kirsty Keating, Leader - EY Law, Kirsty.keating@nz.ey.com; Tel: +64 274 899 090
Silvia McPherson, Senior Associate, EY Law, silvia.mcpherson@nz.ey.com; Tel: +64 21 927 383

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\(^1\) [2016] NZSC 29
\(^2\) [2016] NZSC 30
Inland Revenue reinterprets tax rules applying to donee organisations

If an entity cannot attain or maintain donee organisation status, not only will donors to that entity be ineligible for tax advantages, but the ability of the entity to raise the funds it needs to carry out its purposes may also be affected.

Charities that apply funds outside New Zealand could lose donee status

Inland Revenue has a longstanding compliance focus on charities. It has released a draft Issues Paper reinterpreting when funds are applied “wholly or mainly” to specified purposes within New Zealand.

The issues paper relates to “donee organisations” – organisations using donated money for charitable, benevolent, philanthropic, or cultural purposes. Organisations that do not apply their funds “wholly or mainly” to specified purposes in New Zealand cannot be a donee organisation unless separately listed on Schedule 32 of the Income Tax Act 2007.

Donations to donee organisations qualify for tax advantages. Therefore any change narrowing who can be a donee organisation is important.

Proposed restricted meaning of “wholly or mainly”

Historically, Inland Revenue has been inconsistent in its approach to whether spending is “wholly or mainly” for specified purposes in New Zealand. But it has taken a view that 51 percent of spend can be sufficient.

The draft Issues Paper raises that bar dramatically. For practical purposes, it now says “wholly or mainly” should be taken to mean 90 percent or more.

An entity could apply as little as 10 percent of its funds to non-qualifying purposes overseas and so lose donee organisation status. We’re not convinced this approach is consistent with case law or represents a fair policy outcome.

Alternatives for charities who don’t meet the high threshold

Since the draft Issues Paper sets such a high “wholly or mainly” threshold, Inland Revenue notes alternatives to ensure donors continue to receive tax advantages from their donations:

► 90 percent isn’t the last word. Organisations falling below the 90 percent threshold will be considered on a case-by-case basis. Inland Revenue promises that any decisions on an entity’s status as a donee organisation will not be based solely on a mechanical calculation.

► Set up a separate fund exclusively for charitable, benevolent, philanthropic, or cultural purposes within New Zealand. Gifts to such a fund would be eligible for tax advantages. However, the exclusivity requirements have strict usage and record keeping rules.

► Apply to be included on Schedule 32 of the Income Tax Act 2007, as this schedule allows a tax advantage for all gifts of money the entity receives.

Draft Issues Paper cannot be relied upon

Draft issues papers produced represent the initial views of the Commissioner of Inland Revenue. As such, they may not be relied on by taxation officers, taxpayers or practitioners.

Even so, our experience is that the approach taken in Inland Revenue drafts will eventually become final more often than not. Inland Revenue will accept submissions on the interpretation, practical issues and policy outcomes raised in this paper until 29 July 2016.

We’re keen to hear your views.

Claire Dilks
Associate Director, Tax
claire.dilks@nz.ey.com
+64 27 489 9397

David Snell,
Executive Director, Tax
david.snell@nz.ey.com,
Tel: +64 21 845 361
How reducing company tax rates can also reduce income inequality in New Zealand

Last month’s Budget continued to hold out the carrot of future tax cuts, seemingly targeted at personal tax rates. But we can make a case that a reduction in the company tax rate may be an alternative way to target economic and income equality objectives.

Recent OECD statistics indicate that New Zealanders’ direct tax burdens are among the lowest in the OECD. In fact the average married couple with two children and one income earning spouse actually pay the lowest amount of tax in the OECD due to Working for Families tax credits. That means reductions in personal tax rates have less impact for the lower paid.

Why reduce the company tax rate?

The current New Zealand company tax rate at 28 percent is higher than the average OECD company tax rate of 25 percent. Overseas company taxes are trending down. For example, the current UK company tax rate is 20 percent and this is programmed to reduce to 17 percent from 1 April 2020. Australia has just announced a gradual reduction in the company tax rate from 30 percent to 25 percent from 1 July 2026. While the company tax rate may be less important than the tax base (the calculation of taxable income on which tax is paid), past experience indicates that global investment patterns are influenced by headline company tax rates.

Who really bears the burden of company tax?

For all the vocal criticism of tax minimisation strategies by global companies, the companies themselves are mere agents when it comes to paying tax. The burden of company tax is actually suffered by companies’ consumers and/or employees and/or shareholders. For companies with pricing power, such as the ones on the receiving end of the most public condemnation, an increase in the price of their products/services is likely what is in store for their critics who insist a greater amount of company tax should be paid.

This is not to say that companies should not pay their “fair share” of tax but we just need to be aware of who really suffers the burden of a higher company tax take.

What has reducing the company tax rate got to do with income equality?

Obviously reducing the company tax rate is not a panacea but it does have potential benefits that are worthy of consideration when tax cuts are in play.

Past studies have indicated there is a high correlation between decreases in the company tax rate and increases in wages (and vice-versa). Much of these increases are likely to find their way to the lower paid, who may also benefit from lower-priced goods and services followed by the tax cut.

This can be at least as effective as tax rate changes which are both poorly targeted (they go to all taxpayers regardless of employment status or needs, and which may be largely abated due to high effective marginal tax rates as Working for Families tax credits or other income support mechanisms abate.

Measures aimed at increasing the wages of the lower paid are likely to be preferable to reducing personal tax rates for people who pay little or no tax by virtue of family support tax credits.

David Haywood
Executive Director
Business Tax Advisory
+64274805382
Public consultation

P ED0186: Payment of Shortfall Penalty Using Losses, draft Standard Practice Statement

If approved this statement will replace Tax Information Bulletin Vol 10, No 3 (March 1998). This draft considers the application of section IW 1 of the Income Tax Act 2007. IW 1 allows taxpayers to pay a shortfall penalty imposed as a result of an income tax liability using tax losses. Deadline for comment is the 15 July 2016.

PUB00228: Goods and Services Tax – single supply or multiple supplies

This draft statement explains how to treat supplies with multiple elements; as a single composite supply or multiple separate supplies. Deadline for comment is 29 July 2016.

PUB00218: Income tax – foreign tax credits – how to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement

This draft statement explains how to claim a foreign tax credit with reference to double tax agreements and provides a handy flowchart as a further aide. Deadline for comment is 29 July 2016.

IRRUIP9: Donee organisations – clarifying when funds are applied wholly or mainly to specified purposes within New Zealand

This draft Interpretation Statement clarifies when funds are applied wholly or mainly within New Zealand and how this affects donee organisations. We think this could have a substantial effect on some donee organisations. Deadline for comments is 29 July 2016.

Technical releases

OS 16/01: Filing an IR10 and section 108 of the Tax Administration Act 1994

This statement replaces and amalgamates a number of statements regarding the disclosure of income. It sets out the Commissioner’s preferred method of disclosing income when filing an annual return. It concludes that the completion of an IR10 is preferential, unless the entity is a significant enterprise. In this case taxpayers must provide a pack of information including their financial statements.

BR Pub 16/05-16/06: Treatment of a subdivision of shares under s CB 4.

These rulings are reissues of BR Pub 13/01 and BR Pub 13/02 and apply from 21 May 2016. They outline the treatment of a subdivision of shares (where the original shares were purchased for the purpose of disposal) and a disposal of subdivided shares under s CB 4. They conclude that subdivided shares are to be treated the same as the original shares.

BR Prd 16/02: SKYCITY share scheme

This ruling relates to an Executive Long-Term Incentive Plan between SKYCITY and its employees. Inland Revenue has provided a breakdown of what amounts constitute taxable income in its ruling. This ruling follows Inland Revenue’s alert on employee share schemes and tax avoidance, discussed in our November 2015 Tax Watch.

IS 16/01: use of computer software acquired for use in a taxpayer’s business

As part of a review of historic items, Inland Revenue has released Interpretation Statement 16/01 updating and replacing TIB Vol 4, No 10 1993 on the use of computer software acquired for use in a taxpayer’s business. It presents little substantial change to the 1993 Policy Statement on computer software and provides that until the Trustpower litigation is resolved the Commissioner will continue to apply IS 08/02: Deductibility of Feasibility Expenditure. This Interpretation Statement does not apply to businesses who develop software for sale.

CS 16/01: OECD information sharing requirements for taxpayer rulings and determinations

The Commissioner’s Statement is part of the OECD’s base erosion and profit shifting (BEPS) initiatives under the BEPS action plan. The Statement informs taxpayers that the Commissioner is obligated to exchange information about taxpayer-specific rulings issued on cross-border activities. This includes all private and product rulings, advance pricing agreements and financial arrangements determinations that fall under the six categories of cross-border activities in the OECD agreement. Taxpayers will not be informed if their information is exchanged.
Tax watch in brief

Regulations

Reduction to mileage rate

The Commissioner has released new mileage rates for the 2016 income year. The mileage rate has decreased from 74c/km to 72c/km. This rate applies to expenditure incurred during the 2016 year for the business use of a motor vehicle and reflects decreases in the cost of fuel.

Recently enacted statutes

Taxation (Residential Land Withholding Tax, GST on Online Service, and Student Loans) Act


Taxation (Transformation: First Phase Simplification and Other Measures) Act

The Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016 gained Royal assent on 2 June 2016. This Act is the first stage in Inland Revenue’s business transformation program to make the tax system and Inland Revenue simpler and more efficient.

The New Zealand Business Number Act 2016

The New Zealand Business Number Act 2016 gained Royal assent on 15 April 2016. The Act allows New Zealand Business Numbers (NZBNs) to be allocated to all businesses operating in New Zealand.
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