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REPORT - FEBRUARY 2021

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The information contained in this report is not advice. We recommend that before readers decide to proceed with any of the matters raised below, that they contact their professional advisors.

2021 …… FINALLY

A very Happy New Year to you all.

We trust that you have managed some time off over the festive season to reflect on the year that has been and have taken the learnings from that to prepare for the new challenges 2021 may bring.

With the pandemic and the glut of commentaries on government concessions to businesses with the intent of sustaining and stimulating growth, our Newsletter went on hiatus in 2020. We welcome you to the year ahead and we look forward to a less disruptive 2021.

COVID-19 has changed the way we work, travel, communicate and live. From overseas travel being only a memory to having to learn to cook during lockdown there are some interesting by-products of Covid-19.

PPE has become a fashion accessory with many large fashion companies entering the facemask industry to provide luxury facemasks due to the increase in demand, as well as many people channelling their inner fashion designer and taking the DIY route and making their own. Towards the end of last year, we saw many using masks to make personal political statements in the USA. The hottest accessory of 2020.

Artificial intelligence algorithms that looked after inventory management, fraud detection and marketing became confused by the sudden and drastic change in behaviour.

The changes continue with ANZ now not buying or selling foreign currency due to a decrease in demand arising from border restrictions.

The next big thing will be the introduction of the vaccine towards the end of March. Those most at risk, such as, border workers, those working in MIQ and their close contacts will be vaccinated first.

Let us all hope that there will not be any further serious outbreak of the virus. Stay safe, be kind and remember to scan the QR codes.

UNCLAIMED MONEY

The IRD has issued us with a reminder of changes that will apply from 1 March 2021, in respect of Unclaimed Money:

If you hold money that has been untouched by the owner for an extended period of time and you can't locate them, you need to submit a schedule of information and pay the amount of unclaimed money to us. The information is used to help identify owners when we receive a claim for the money.

Changes that will apply from 1 March 2021:

- If you're a holder organisation and have provided your IRD number for processing unclaimed money, a new 'Unclaimed money holder' account will automatically be created in your myIR account.
- You'll be able to submit schedules, pay unclaimed money, view previous transactions and contact us through myIR.

An example schedule template can be found at ird.govt.nz/unclaimed-money-filing

Intermediaries such as tax agents, bookkeepers or representatives will be able to link to the 'Unclaimed money holder' account if you give them permission.

Some of the changes are dependent on legislation which is expected to pass in March 2021*:

- The length of time funds are held before becoming unclaimed money may change. All funds held by holders may be deemed as unclaimed after 5 years, instead of the current 6 or 25 years.
- There would be a transitional period of 2 years to help you shift to the new timeframe.
- You may need to provide more customer information which will be used to help claimants identify which money is theirs and whether to pursue a claim.
- If you have unclaimed money to send to us, you may need to submit schedules more regularly and payments will need to be made at the same time. We'll confirm the filing and payment dates once the legislation has passed.

The requirements for holders to send a letter to customers' last known address and to maintain a public register may also be removed if a reasonable effort has already been made to contact the customer.

FIXED ASSETS: The $5,000 temporary threshold to write-off asset (plant & equipment) purchases as expenses, comes to an end on 16 March 2021. From 17 March, it reduces to $1,000 .

HEALTHY HOMES COSTS DEDUCTIBILITY

If you are an owner of a residential property, you will be familiar with the Healthy Homes Standards that were introduced on 1 July 2019. The standards set out the minimum requirements all landlords are required to comply with. Examples of the mandatory requirements include fixed heaters in the main living room, smoke alarms, ceiling and underfloor insulation and ground moisture barriers for some properties. For older homes, the costs of bringing a residential rental up to the standard required could be substantial.

Inland Revenue (IRD) recently released QWBA 20/01, which provides guidance on the deductibility of the costs incurred to meet the Healthy Homes Standards. To summarise, the statement broadly classifies such expenditure into three categories:

- revenue expenditure that is immediately deductible,
- capital expenditure that forms part of the building and is therefore unable to be deducted at all because the depreciation rate for residential buildings is 0%, and
- capital expenditure that does not form part of the building and is therefore likely to be depreciable.

The Commissioner has stated that expenditure will be capital if the work results in the reconstruction, replacement or renewal of the whole asset or substantially the whole asset, or goes over and above making good wear and tear and changes the character of the asset beyond a repair. Conversely, expenditure that does not meet this definition will be revenue in nature and immediately deductible.

The QWBA also provides that the cost to repair items that would otherwise meet the standards if they were in an operational or reasonable condition, are likely costs of a revenue nature and hence immediately deductible.

In the QWBA, IRD commented the following capital items are likely to comprise part of the building and therefore unable to be depreciated due to buildings having a 0% rate:

- smoke alarms
- insulation
- openable windows
- exterior doors
- ducted or multi-unit heat pumps
- most extractor fans or rangehoods
- ground moisture barriers
- drainage systems

The cost of a capital item that does not form part of the building may be either depreciated over time or deducted immediately if it meets the 'low-value asset threshold'. For assets that fall into this narrow category it would be worth making the upgrades between now and 16 March 2021 because **the threshold has been temporarily increased to $5,000** and will reduce to $1,000 from 17 March 2021 onwards.

Examples of such assets provided in the QWBA are:

- electric panel heaters
- single-split heat pumps
- through-window extractor fans and window stays
- door openers and stops

Unfortunately, it appears no tax relief has been introduced for residential rental owners who are required to spend considerable cash on upgrading their properties to comply with the Healthy Homes standards. IRD's position is reminiscent of their view on leaky home repairs, for which tax disputes are on-going.

PURCHASE PRICE ALLOCATIONS

Currently, if you enter into a sale and purchase agreement for the sale of business assets, there is no standard practice for how the price should be allocated to the assets. For example, a single price may be agreed for all assets, or the agreed price might be allocated on a line by line basis to each asset.

If the purchase price is not allocated with sufficient detail, inconsistent outcomes can arise when each party takes a tax position.

Take, for example, a business comprised of land and depreciable property that is being sold for $800k. The vendor's fixed asset register includes depreciable property that originally cost $400k that has been depreciated down to $150k, and land that originally cost $350k.

The vendor takes the view that the depreciable property was sold for $100k and claims a $50k loss on disposal. The $350k gain on the sale of the land is treated as a non-taxable capital gain. Conversely, the purchaser treats the depreciable property as purchased for $250k (thereby providing a future depreciable cost base of $250k), allocating the remaining $550k purchase price to the land.

The mismatch between the consideration adopted by the vendor and purchaser in relation to the depreciation property will mean their total tax deduction is overstated by $150k. The difference in value is funded by the Government – it is 'out of pocket'.

To avoid this outcome, draft legislation was introduced in June 2020 that prescribes how assets are to be treated on sale. The proposed legislation provides an ordered approach:

1. If the parties agree a purchase price allocation, they must both follow it in their tax returns.
2. If the parties do not agree an allocation, the vendor is entitled to determine it, and must notify both the purchaser and IRD of the allocation within two months of settlement date. However, the allocation to taxable property cannot result in additional losses on the sale of that property.
3. If the vendor does not make an allocation within the two-month timeframe, the purchaser is entitled to determine the allocation, and notify the vendor and IRD.
4. If no allocation is made by either party, the vendor is treated as selling for market value, but there is a risk the purchaser is deemed to acquire property for nil.

A de-minimis has also been proposed – if the parties do not agree an allocation, the rules will not apply to a transaction if the total purchase price is less than $1 million, or the purchaser's total allocation to taxable property is less than $100,000.

Irrespective of the agreed values, IRD may still challenge them if they consider they do not reflect market value.

The rules will apply to sale and purchase agreements entered into from 1 April 2021.

ELECTION OUTCOME & TAX POLICIES

After Labour's victory in the 2020 General Election, their proposed tax policy changes are now likely to be implemented. Labour has ruled out a capital gains tax and an increase in fuel taxes but is prepared to introduce a Digital Services Tax to target multinational digital businesses who have taken advantage of tax structuring options. Labour's historical coalition partner, the Green Party, have notably been campaigning for a wealth tax, which Labour has repeatedly ruled out. Given that Labour has won enough seats to govern alone, the possibility of a wealth tax seems unlikely.

Labour's election campaign promised no income tax changes for 98% of New Zealanders, however a new top marginal income tax rate of 39% for individuals earning over $180,000 will be implemented – expecting to raise $550 million of revenue a year.

For some of us this provides a sense of déjà vu, as we remember when we previously had a 39% tax rate from the 2001 to 2009 financial years. We saw disputes in the courts regarding the requirement to pay fair market salaries, legislation requiring income to be attributed to individuals and various policy statements from Inland Revenue. As differences in tax rates widen, it impacts behaviour by incentivising tax planning to minimise application of top tax rates. Currently, there is little difference between the top income tax rates, 33% for trusts and individuals and 28% for companies. It also leads to further inequity within the tax system because it is typically employees who are unable to alter how they are taxed, whilst business owners have greater flexibility to alter how their income is taxed.

For example, a distribution of accumulated income from a trust that has already been taxed at 33% may be distributed tax-free to a beneficiary who has a marginal tax rate of 39%. Individuals with investment income may also be further incentivised to invest in Portfolio Investment Entities instead of shares, where the top tax rate is capped at 28%. Conversations are likely occurring right now regarding whether shares in companies should be moved from personal ownership into trusts – and whether this is tax avoidance?

Companies will also face further costs with a 39% tax rate. Companies that currently pay fully imputed dividends at 28% are also required to withhold tax at 5% in order to reach the 33% marginal income tax rate. This withholding tax liability is likely to increase to 11%, which may place constraints on company cash flow or prevent dividends from being paid altogether. This will place further pressure on tax administration to keep accurate, up-to-date records as individuals on lower marginal tax rates may be entitled to tax refunds comprising the additional tax withheld.

Ultimately, this policy provides an opportunity for individuals to explore their different options to ensure efficient tax planning. However, utmost care should be taken when restructuring one's affairs, in order to avoid undesirable consequences such as the breach of shareholder continuity resulting in the loss of imputation credits or tax losses, or potentially undertaking a tax avoidance arrangement.

NEW TRUSTEE DISCLOSURE OBLIGATIONS

In 2013 the law commission was asked to review the Trustees Act 1956 and NZ Trust law generally. Following this initial review, nearly eight years later, the long-awaited "Trusts Act 2019" will finally come into effect on 31 January 2021, replacing the entire 1956 Act.

One of the most significant changes in the new Act that is generating interest from trustees and practitioners alike is the introduction of beneficiary disclosure requirements on trustees. This becomes sensitive if it means disclosing a trust's financial information, or to what extent some beneficiaries have benefitted more than others. However, the problem is what level of information should be disclosed and to whom?

Under the new Act, there are two layers to the disclosure obligations:

A "presumption" exists that Trustees will make available "basic trust information" to every beneficiary.

A beneficiary may request additional "trust information".

Basic trust information comprises:

- the fact the person is a beneficiary of the trust,
- the name and contact details of the trustees,
- any changes to the trustees as they occur,
- their right to request a copy of the trust deed, and
- their right to request trust information.

"Trust information" has a wide definition and includes information regarding trust property. Although, it specifically excludes "reasons for trustees' decisions". It is reasonable to assume 'trust information' includes financial information, but how detailed that information has to be is unclear, e.g. does it include amounts distributed to other beneficiaries? Given the new rules are intended to ensure beneficiaries have sufficient information to enforce the terms of the trust deed, it is presumed the answer is yes.

Before making "basic trust information" or "trust information" available to beneficiaries the trustees have to consider numerous factors, including:

- the personal or commercial confidentiality of the information,
- the age and circumstances of the beneficiary,
- the practicality of giving the information, and
- the effect on the beneficiary and family relationships of providing the information.

After taking all factors into consideration, the trustees can decide to withhold information from beneficiaries if they "reasonably" consider the information should not be provided.

The wording of the new Act is causing uncertainty and unease with existing Trustees as to what exactly their new obligations are and the risk of acting unreasonably. At one end of the scale, risk averse trustees are considering trust resettlements to establish new Trusts with a reduced number of beneficiaries, to preserve confidentiality or reduce the risk of litigation by beneficiaries. At the other end of the scale, trustees are awaiting case law to set the precedent on how to "reasonably consider" the factors above.

Although the legislation needs to be applied correctly (which in itself is uncertain), each situation is different based on the nature of family and beneficiary relationships, which makes it difficult to determine the best course of action.

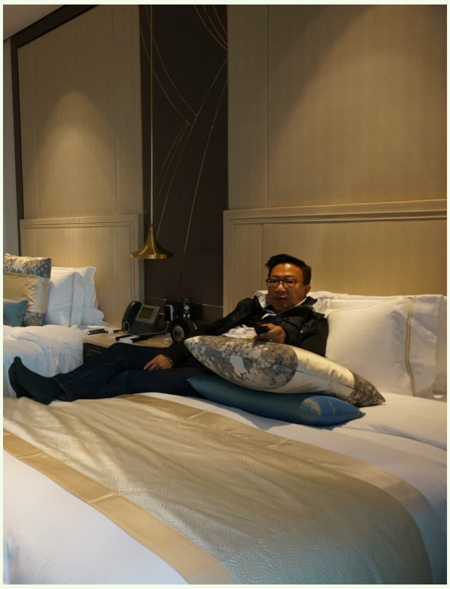
EMPLOYEE ACCOMMODATION

The treatment of employee accommodation (and taxable allowances) can be confusing. In 2015 the rules around employer-provided accommodation were subject to a reform, with the changes intended to provide greater clarity and cohesion for employers to understand their tax obligations. Previously, a net benefit approach was acceptable, where accommodation provided to an employee was not taxable if the employee maintained a home in another location. Following the reform, the starting point is that accommodation provided to employees is taxable unless one of the exemptions apply (e.g. temporary, out-of-town secondment, work-related conference). But how should it be taxed?

Firstly, PAYE typically applies to the provision of a cash allowance paid to an employee. While FBT usually applies to a non-cash benefit (such as the use of a car). However, the provision of accommodation comprises taxable income and is subject to PAYE, rather than FBT.

The amount of taxable income is the market rental value of the employee accommodation, less any contribution to the cost by the employee.

There are a number of Inland Revenue publications available to assist employers with determining the market rental value. For example, Commissioner's Statement CS 16/02 sets out the Commissioner's opinion on factors that can and cannot be taken into account; and CS 18/01 suggests market value reductions in the form of percentages specifically for boarding school employers. The overarching theme of the guidance is that employers have flexibility when determining the market rental value as long as a reasonable process is followed, and sufficient evidence is maintained to support the values used. For example, an independent valuation could be obtained by a registered valuer, or an analysis of comparable rental properties could be undertaken. Further, an employer is able to apply their own reduction percentages that they consider to be appropriate for any given accommodation type.



Although such guidance is useful, there is little Inland Revenue guidance regarding how to calculate the PAYE itself, which can lead to confusion.

The PAYE liability varies depending on whether the employee or employer pays the PAYE. If the employee's net income in the hand does not change with or without the addition of the taxable accommodation amount, then the employer is likely to be paying the PAYE. In this situation the market value of the accommodation should be grossed up and PAYE calculated based on the grossed-up amount. For example, assuming a 33% tax rate, a $300 market rental value would be grossed up to $448 to calculate a corresponding PAYE liability of $148.

If the employee receives less in the hand with the addition of the accommodation, the employee is funding the PAYE out of their salary or wage and the taxable amount is the market value of the accommodation itself. For example, a $300 market value would result in a $99 PAYE liability and the employee would receive $99 less in the hand.

Ideally, who is liable for the PAYE should be captured within the employment agreement, so that both parties know what to expect and are not caught out.

GREENER GRASS OVER DITCH?

When Australia released its last Federal Budget it planned to combat the effect of Covid-19 by investing in infrastructure, job creation, asset write offs and personal tax cuts. Meanwhile in New Zealand, Labour continues their plan to keep New Zealand moving by investing in people, jobs, small businesses, infrastructure and global trade.

Australia's approach of increasing the low-middle tax bracket thresholds is similar to what National proposed, with eligible Australians receiving tax relief of up to $2,745. These tax cuts are provided to encourage spending and stimulate the economy. Conversely, in New Zealand there will be a new top tax rate effecting 2% of New Zealanders and generating $550 million of annual revenue.

Australia has extended its $150,000 asset write-off deduction until 30 June 2022 for businesses with a turnover of up to $5 billion. In New Zealand our threshold has been increased to $5,000 until 16 March 2021, then $1,000 thereafter.

Both countries have implemented tax loss carry back changes. In Australia small businesses can carry back tax losses from the 2020-2022 tax years to offset previously taxed profits in 2019 or later tax years. All New Zealand businesses expecting to make a loss in the 2020 or 2021 year can use that loss to offset profits they made the year before. The key difference is that in New Zealand tax losses can be carried back one year, while in Australia they can be carried back to any year from 2019.

Additional Australian policies to boost job creation include a job hiring incentive credit where businesses will receive either $100 or $200 per week for each employee hired depending on their age, and businesses taking on new apprentices or trainees will be eligible for a 50% wage subsidy.

新年快乐 HAPPY NEW YEAR OF THE OX

新的一年再度来临， 2020年对很多人来说，是非常具有挑战性的一年，但我们也不畏艰难地度过了，相信在这2021年我们能再次携手克服一切，迈向一个更憧憬的未来。在此我们全体同仁恭祝各位牛转乾坤行大运，平安健康，恭喜发财！

IMPORTANT TAX DATES

2nd Day after Payment of wages - Payday Filing to IRD

5 February - PAYE due for large employers

20 November - PAYE , RWT, NRWT Returns are due

28 February - GST due for period-end January

5 March - PAYE due for large employers

20 March - PAYE , RWT, NRWT Returns are due

31 March - Income Tax Returns for March '20 are due

5 April - PAYE due for large employers

7 April - Terminal Tax is due