BDO Backing precision

Spring 2015
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SPRING TAX REFORMS HEAVY IN BUD

The Policy Advice unit of Inland Revenue have been busy over winter. Six Issues Papers, a host of Tax Bills and all released within a short period of time. It's an impressive output and the Inland Revenue's Business Transformation and the OECD's BEPS announcements simply add to the heavy bud of tax reforms in spring 2015.

This is the release of a significant body of work and is worthy of careful analysis and active consultation. Not all changes will impact immediately and some may not come to flower or bear fruit. But all need care and attention.

This spring release makes a change from prior years where significant announcements were often made immediately prior to Christmas providing tax professionals with thrilling holiday reading. However the timing is not ideal as there is a small matter called the Rugby World Cup 2015 to survive.

Enclosed is a high level summary of some of the more interesting changes and proposals. Your BDO adviser will be happy to discuss any aspect of the tax reforms with you or if you prefer we can talk about the rugby!

Regards,

Iain

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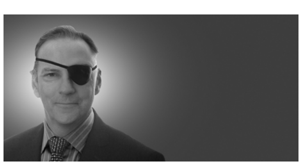

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AT A GLANCE

Tax Bills	Status	Important Dates
Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill	Omnibus Tax bill reported back to Parliament for a second reading. Contains provisions on R&D Tax Credits; Body Corporates and GST; and provisions to improve deductibility of black hole expenditure; CFC and FIF remedial reforms.	Various effective dates but many changes to be effective from 1 April 2015 or start of 2015 – 16 income year. (See Winter Edition Tax Today)
Taxation (Land Information and Offshore Persons) Bill	Tax Bill requiring offshore investors in land to obtain IRD numbers and in some cases open a bank account.	1 October 2015 with additional information to be provided from 1 April 2016
Taxation (Bright Line Test for Residential Land) Bill	Two year bright line test for disposal of residential property with limited exemptions.	Applicable on residential property acquired after 1 October 2015

Proposals	Status	Date
GST on online Purchases	Government Discussion Document	Submissions closed 25 September 2015
Debt Remission Reform	Announcement of reform of debt remission to proceed to legislation	Retrospective from 1 April 2006
Residential Land Withholding Tax	Officials Issues Paper proposing a withholding tax on residential land by offshore sellers	Aiming for an effective introduction 1 July 2016
Closely Held Company Taxation Issues	Officials Issues Paper proposing major changes to how closely held companies and their shareholders are taxed	Submissions close on 16 October2015
Loss Grouping and Imputation Credits	Officials Issues Paper proposing an imputation credit transfer from a loss company to a profit company where losses have been previously grouped	Submissions close on 27 October2015
GST Rule Fixes	Officials Issues Paper seeking feedback on changes to GST rules to make them work better	Submissions close on 30 October 2015

LOSS GROUPING AND IMPUTATION CREDIT TRANSFER

This Officials' Issues paper is targeted at a single issue - the deficit in imputation credits a profit company can experience where the profit company has benefited from a tax loss transferred from a fellow group company.

Imputation credits arise where a company pays income tax. A reduced amount of tax is paid where the company benefits from a group loss offset. Group loss offsets are performed by way of an election to transfer the loss from the loss company to a group company with taxable income. Where the loss is transferred by way of an offset the profit company can end up with a mismatch between its retained earnings and the balance of imputations credits.

Losses can also be transferred by way of a subvention payment. Originally subvention payments, which are a deductible expense to the profit company, had to be made for a dollar equivalent of the loss transferred. It remains a useful mechanism. It provided funds to the loss company which it could use to repay intercompany debt (which often arose from the profit company funding the losses). It would also lower the retained earnings of the profit company providing a better match between its imputation credits and its retained earnings.

However the use of subvention payments for a full dollar for dollar basis is not always appropriate and many companies choose to make a subvention payment equivalent to the tax effect of the losses (28%) and transfer the balance of the loss (72%) transferred by way of the loss offset election.

Any deficit in imputation credits arising from a group loss offset or a 28% subvention payment inevitably results in any shareholder who does not benefit from the wholly owned inter-company dividend exemption incurring additional tax liability on receiving a dividend that would otherwise have been fully imputed.

Officials have received submissions that this is driving corporate behavior on mergers and acquisitions where 100% share ownership is often pursued to benefit from the dividend exemption. However such ownership may not be in the bests in interests of the economy.

The solution proposed is to allow an imputation credit transfer from the loss company to the profit company at the time a dividend is paid by the profit company. The imputation credit transfer will be agreed between both companies and cannot be by unilateral election.

It is intended to apply where the loss company is a parent company and the profit company a subsidiary; or where both are sister companies with a common shareholder corporate parent. It is not intended to apply where the parent company is the profit company and the loss sits in the subsidiary as there are existing mechanisms for transferring the imputation credits around the group in such circumstances.

Comment

It is an interesting business friendly proposal which is likely to have a relatively narrow application. The time between the loss offset and the payment of a dividend and transfer of imputation credits is likely to challenge record keeping as a number of years may pass between these two events. Care will always be required to ensure the loss company which makes the imputation credit transfer doesn't end up with a debit balance in its own imputation credit account and be exposed to the 10% imputation penalty. We expect this issue to be canvassed during the submission process.

PROPERTY TAX CHANGES

We have previously outlined the proposed property tax changes in earlier editions of Tax Today.

The introduction of the two year bright line test for residential property is in consultation process but the requirement for offshore investors to obtain an IRD number and open a bank account in NZ has been passed and came into effect for all residential property acquired after 1 October 2015.

A further proposal has been released outlining a potential residential land withholding tax (RLWT) on the sale of residential land in New Zealand. The RLWT would likely require an amount to be withheld by a conveyancer or solicitor and paid to Inland Revenue.

The amount to be withheld would be the lower of:

- 33% of the vendor's gain on that property (i.e. 33% x (agreed total sales price - vendor's acquisition price)); and
- 10% of the total purchase price of that property.

The effective date is expected to be for settlements occurring on or after 1 July 2016.

The RLWT would apply where the vendor of the residential property is both an "offshore person" and taxable under the two year bright-line test.

Note while the proposed bright-line test applies to residential land regardless of the geographic location the RLWT is to be restricted to residential land in New Zealand.

The withholding agent should be entitled to rely on the statement provided by the vendor, unless they know it to be false. In such a case, the withholding agent would be required to withhold and pay RLWT to the Commissioner.

It is intended for the RLWT to be withheld before any other amounts are disbursed in relation to the sale of the property.

CLOSELY HELD COMPANIES

The review of the taxation of closely held companies has been in the IR work program for some time and while their issues paper focuses largely on look through companies (LTCs) it also contains important proposals on how closely held companies and their shareholders should be taxed.

The document discusses reforms to:

- The entry criteria for becoming an LTC
- Restrictions on the use of LTCs by non-residents
- Simplification of the deduction limitation rule.
- Amendments to aspects of the dividend regime.

In addition, Qualifying Companies (the predecessor to LTCs) are expected to retain their status as QCs until there is a change of ownership. There are also technical fixes proposed on entry into the LTC regime with pre-entry reserves to be taxed at marginal rates; and for debt remission where a debt owed to the shareholder by an LTC is remitted because the LTC cannot repay the debt.

Entry criteria

The proposed changes to companies who are eligible to become LTC's are significant particularly where the shares in the LTC are owned by trusts, charities or Maori Authorities.

For trusts it is proposed that

- A beneficiary that has received any distribution in the last six years should be a "counted owner" for the purposes of determining if there are five or fewer shareholders.
- A company should not be eligible for LTC status if a trust that is a shareholder makes a distribution to a corporate (non-LTC) beneficiary.
- The trustee should continue to be a single counted owner in the event that no distributions are made in the relevant period (last six years).
- Charities and Maori authorities are to be precluded from being shareholders in LTCs or beneficiaries of trusts that own shares in LTCs. This would not impact on standard charitable donations.

More than One Class of Share

Officials propose to allow more than one class of share to be issued by an LTC without the LTC status being compromised. The different class of share can provide for different voting rights but all shares in the LTC must have uniform entitlements to income and deductions.

Non-residents and LTCs

The IR appear concerned at the use of a LTC as a conduit vehicle by non-resident shareholders to invest in foreign assets. A corporate structure that in some ways mirrors the NZ foreign trust regime.

After careful consideration the officials accept that a hybrid entity such as an LTC should remain available for a non-resident investing in NZ assets; and for NZ residents investing through an LTC in offshore investments.

However they propose to restrict the use of LTCs for offshore investments by limiting the foreign income a LTC can derive to the greater of $10,000 or 20 percent of its gross income when more than 50 percent of the LTC's shares are held by non-residents if it wishes to retain its LTC status.

Deduction limitation rule

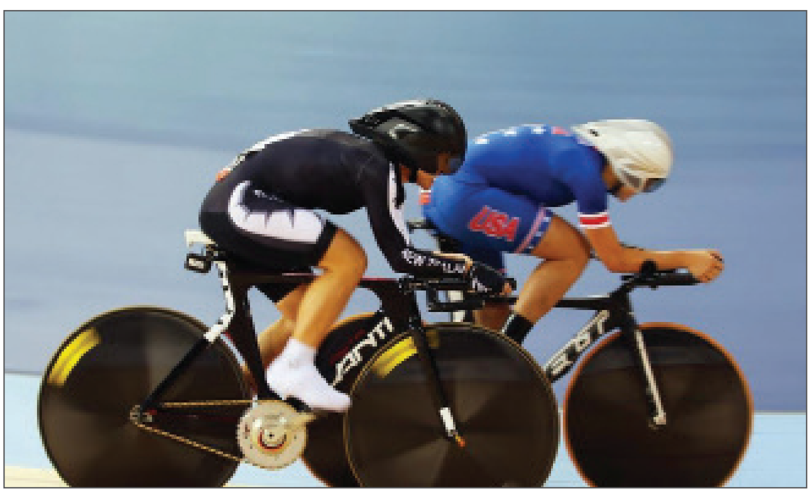
Since LTC's were introduced to replace the Loss Attributing Qualifying Company (LAQC) regime there have been various quirks identified in the deduction limitation rule which was often referred to as the loss limitation rule.

There are a number of proposed changes and technical amendments to improve the ability of owners to get a deduction with a pleasing concession which would allow an immediate deduction against a shareholders' other income in the 2017–18 income year for any deductions that have had to be carried forward due to the prior deduction limitation rule.

Dividend Simplification

Initiatives to simplify and reduce the compliance and administration costs associated with closely held companies that are neither LTCs nor QCs include:

- Amending the restrictions around tainted capital gains to ensure that genuine capital gains made by small businesses do not become taxable on liquidation merely because there is a transaction involving an associated non-corporate party.
- Making the deduction of RWT from fully imputed dividends between companies optional rather than obligatory.
- Optional removal of resident withholding tax (RWT) obligations from small companies in respect of the dividends and interest they pay to their shareholders. This reform to be considered as part of a wider body of work on streamlining business tax processes.
- Streamlining RWT obligations when cash and non-cash dividends are paid concurrently so that they can be treated as a single dividend.
- Allowing shareholder salaries to be subject to a combination of PAYE and provisional tax provided the company maintains the approach consistently from year to year.



BACKING PARALYMPIAN FIONA SOUTHERN ON HER MEDAL QUEST FOR RIO 2016

BDO is proud to support Fiona Southern, London 2012 Paralympics bronze medallist. Fiona has been a strong ambassador to BDO and has ridden for BDO in the 4 day BDO Tour of Northland and 7 day BDO Wellington to Auckland Cycle Challenge.
Fiona has now qualified for the Duathlon World Championships in Adelaide in October and is in a strong position to qualify for the Paralympics in Rio de Janeiro in 2016. Please join BDO in backing Fiona to get there by donating to Fiona's givealittle page:

https://givealittle.co.nz/cause/helpfionatorio

GST RULE FIXES

The New Zealand GST system is broadly based with few exemptions or exclusions. It is designed this way to make it relatively easy to comply with and efficient to administer.

Nevertheless as we approach the 30th anniversary of GST being introduced some refinement is still required and a number of interesting issues and rule fixes have been canvassed by Officials in the "GST: Current Issues" paper.

The key reforms discussed include:

- Clarifying the right to an input tax credit for GST on costs associated with the costs of raising capital. Input tax credits are not available on such costs as they are deemed to not be incurred in making taxable supplies.
- Offer large, partially exempt, businesses such as retirement village operators who make mixed supplies to agree an alternative method of GST apportionment with Inland Revenue.
- Provide an ability to claim a secondhand goods deduction for goods composed partially of gold, silver and platinum.
- Clarify the ability to zero-rate services provided in connection with land in New Zealand including setting out what services should be regarded as directly in connection with land and therefore standard rated.

There are also some technical and remedial changes suggested to with:

- Agents acting on behalf of purchasers and their principals.
- Accounting for GST on supplies of goods and services where total consideration is not known at the time of supply.
- Allowing zero-rating of goods and services that are provided in relation to ships and aircraft that are exported under their own power.
- Ensuring a person remains eligible to receive a refund for overpaid tax due to a clear mistake or simple oversight where they were in a tax payable position during the relevant period.

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