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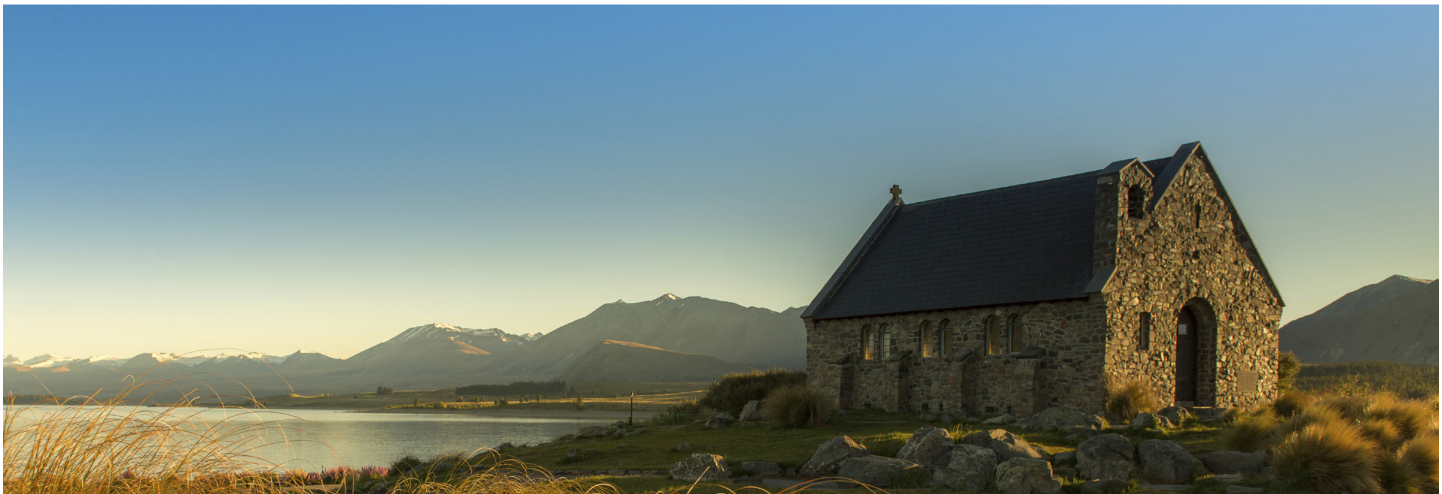
TAX TODAY



TAX RESIDENCY

INLAND REVENUE'S RECENT INTERPRETATION STATEMENT PROVIDES OPPORTUNITY TO BETTER UNDERSTAND TAX RESIDENCE

Inland Revenue recently released an Interpretation Statement on Tax Residence (IS 14/01 – *Tax Residence*). It provides an opportune reminder of the importance of a person's tax residence.

Tax residence determines whether a person is liable to tax on their worldwide income; or only on NZ source income as a non-resident.

It is also central to the application of many specific tax regimes. For instance: transitional tax resident regime; overseas superannuation concessions; foreign investment fund rules; controlled foreign company rules; thin capitalisation regime; withholding taxes on interest and dividends; working for families; and the Student Loan Scheme. So it is fundamental to understand whether a person is a NZ tax resident.

The Basics

Tax residency is a different concept to residence for immigration purposes. An individual is a tax resident ifs/he:

- is physically present in NZ for more than 183 days in a 12 month period; or
- has a "permanent place of abode" in NZ.

An individual ceases to be a NZ tax resident if s/he:

- is physically absent from NZ for more than 325 days in a 12 month period; and
- does not have a permanent place of abode in NZ.

The Interpretation Statement aims to provide clarity over how Inland Revenue will apply the tax residence test and, in particular, its view (based on recent case law decisions) as to how the permanent place of abode test should be applied.

The term permanent place of abode is not defined in the Income Tax Act 2007. However, case law establishes that the expression means a fixed and habitual place of abode, a place of abode with which the person has an enduring relationship and where the person habitually or normally lives.

Inland Revenue acknowledges that to have a permanent place of abode a person must have a dwelling available to them in New Zealand. This represents an important shift by Inland Revenue as it previously treated the availability of a dwelling as being one (albeit important) factor to be taken into account.

Having a dwelling available is a pre-requisite to having a permanent place of abode but it does not of itself give rise to a permanent place of abode. There must also be a requisite strength of connection (see below).

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TOPICAL TAX ISSUES

GST SECOND-HAND GOODS CLAIMS

A recent case in January of this year highlights that GST and second-hand goods claims continues to be a hot topic.

A GST second-hand goods claim may be permitted, for example, where a GST-registered person acquires goods from a non-registered person. By way of an example, JCo Ltd, a GST registered person, acquires land from John, a non-GST registered person, for $100,000. JCo Ltd may be entitled to a GST second-hand goods claim of around $13,000 (being the GST fraction of the $100,000 purchase price).

The rules are in place to prevent a registered person from being disadvantaged by purchasing goods from a non-registered person.

Commonly missed is that a second-hand goods claim can be restricted where the registered purchaser and non-registered vendor are "associated". Association is far reaching, so if you think you are associated, you probably are.

If the parties are associated, the GST second-hand goods claim is restricted to the lesser of:

- The GST fraction (3/23) of the purchase price;
- The GST fraction (3/23) of the market value (if different from the purchase price); and
- The GST that was originally included in the cost of the goods to the associated vendor.

Using our example above, let's suppose John is the sole shareholder of JCo Ltd. Let's also suppose that John originally acquired the land in September of 1983 and it was sold to JCo Ltd for fair value.

In establishing whether or not JCo Ltd's GST second-hand goods claim would be restricted, firstly are John and JCo Ltd associated? This is easy to answer. Broadly, a person is associated with a company if they hold at least 25% of the shares. As the sole shareholder, John is associated with JCo Ltd. Any GST second-hand goods claim available to JCo Ltd is therefore restricted to the lesser of:

- The tax fraction of the purchase price, 3/23 of $100,000, i.e. around $13,000;
- The tax fraction of the market value, as per above, around $13,000;
- GST originally imposed on John.

GST was introduced on 1 October 1986. Therefore as John acquired the land before GST was in operation, he can't have been charged GST on that purchase. As such the restriction reduces JCo Ltd's GST second-hand goods claim to nil. It's definitely something to watch for.

- Stuck with a GST issue? Get in touch with your local BDO Tax Adviser

FOREIGN SUPER-ANNUATION RULES - LAST REMINDER!

As previously mentioned in earlier Tax Todays, the taxation of foreign superannuation will change from 1 April 2014. There are concessionary rules that taxpayers can elect to use where they have either transferred (to New Zealand) or withdrawn their overseas superannuation between 1 January 2000 and 31 March 2014. This is for taxpayers who have not previously complied with their income tax obligations arising from the transfer.

Broadly, under the concessionary rules, 15% of the withdrawal / transfer will be treated as income (which will then be taxed at the appropriate marginal tax rate).

Once the new rules apply (from 1 April 2014) the amount that will be treated as income may be higher (depending on the taxpayer's individual circumstances). There is therefore an opportunity for taxpayer's to withdraw / transfer their superannuation prior to 31 March 2014 and only treat 15% as income.

The rules have been amended to extend the availability of the 15% option to those whose funds have not actually been transferred prior to 31 March 2014 but who can show that they have lodged an application before the deadline. There is still a very brief window to use the concessionary rule.

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The Interpretation Statement includes a flow-chart (at page 7) that summarises the test as follows:

Is the dwelling your permanent place of abode?
Consider whether it is the lasting or enduring place you usually live, or a place you can live when required, in a locality with which you have a durable connection and that is a current focal point of your living, taking into account the following:

- Whether your presences in NZ / absences from NZ have been for continuous or interrupted periods;
- The length of your presences in or absences from NZ;
- Your overall connections with NZ and with the dwelling, including:
  - The nature and use of the dwelling and your connection with it (consider ownership, past use and intended future use);
  - Your intention as to your future presence in / absence from NZ. Also consider what has occurred if it is different to what was intended;
  - The strength of your family and social ties in NZ (location of family and friends, other social ties such as memberships of clubs etc).
  - Any employment or business interests or ties you have in NZ;
  - Any economic ties you have to NZ;
  - Any personal property you have in NZ.

Conclusion
An objective of the tax residence test is to make it easier for an individual to gain tax residency than to lose it.

Two recent tax cases in the Taxation Review Authority on the subject of tax residence display a willingness by Inland Revenue to challenge claims that an individual is not a tax resident. Inland Revenue has also been questioning whether people who use overseas credit cards in NZ, and who are spending time here, are a tax resident.

The Interpretation Statement is an important document to refer to in determining the impact of a change in a person's circumstances. Given the complexity of determining tax residence (the Interpretation Statement is 88 pages long and this article only touches on the topic in general terms), there is value in consulting your BDO adviser if there is any uncertainty as to your tax residency status.

The Interpretation Statement also contains important material on the tax residence of Companies and Trusts.

The Interpretation Statement applies from 1 April 2014. There are transitional rules if you applied the Inland Revenue's previous approach in earlier years. Your BDO adviser will be able to explain their application to your circumstances.

- For more information please contact your local BDO Tax Adviser

YEAR-END TAX TIPS

WE'VE COMPILED A LIST OF OPPORTUNITIES YOU CAN TAKE TO ASSIST IN MINIMISING YOUR TAX LIABILITIES.

Bad debts

You can claim a deduction for bad debts that are physically written off. It's not a case of just writing off bad debts as you see fit, you must still go through a process of determining that a debt is indeed bad. A debt is considered bad if a reasonable and prudent business person would be of the view it is unlikely that the debt will be paid. Factors to consider are the length of time the debt is outstanding and the efforts that you have taken to collect the debt and information on the debtor. A debtor does not need to be insolvent for the debt to be bad, so you can still pursue the debtor for payment.

Imputation credit accounts

It is important that a company's imputation credit account is in credit at 31 March. Failing this will result in a 10% imputation credit account debit penalty. As a solution you may wish to consider accelerating provisional tax payments prior to their normal due date.

Donations

Charitable donations made by companies to an approved charitable donation are deductible (to the extent the company has taxable income). If you are thinking about making a donation, consideration should be given to making this prior to 31 March.

Fixed assets

Don't forget that you can claim a deduction for the purchase of fixed assets (depreciable property) costing $500 or less (GST exclusive). This is subject to various provisos.

We also consider it is worthwhile reviewing the fixed asset register to identify assets that are no longer used (nor will be) in the business. A deduction can be claimed for the tax book value of assets which are no longer used in the business, providing that the cost associated with physically scrapping the asset would exceed any consideration receivable.

Legal fees

There is a fine line between capital (non-deductible for tax purposes) and revenue expenditure (deductible). We recommend legal fees are scrutinised to determine whether they are capital or revenue expenses. Note that an automatic deduction is available for legal fees of $10,000 or less (GST exclusive), i.e. there is no need to consider the capital limitation. If the total fees exceed $10,000 then all of the expenditure must be scrutinised from a capital or revenue perspective (i.e. there is no automatic deduction for the first $10,000 of expenditure incurred).

Employee related provisions

A deduction is available for employee related provisions (e.g. holiday pay, bonus accruals, long-service leave) if they are paid within 63 days of balance. For a 31 March balance date, payment must be made by 2nd June for the amount to be deductible.

Tax Pooling

Tax Pooling is a great tool to reduce a taxpayer's exposure to use of money interest. If you have not paid enough provisional tax during the year, it may be more cost effective to purchase the required tax through a tax intermediary (at the required dates) than pay the amount directly to Inland Revenue. The interest rate differential between the cost of purchases from tax intermediary and Inland Revenue's use of money rate is approximately 2%. Income tax can be purchased through a tax intermediary within 75 days of your terminal tax date.

Elections

Don't forget that various tax structures and options require elections to be made within prescribed time frames:

Look Through Companies
With the exception of newly incorporated companies the election must be made before the start of the income year to which the election is intended to relate, i.e. before 1 April 2014 if you wish the LTC rules to apply from that date. For newly incorporated companies an election can be made up to the date of filing the first income tax return. If an existing LTC wants to exit the regime for the next tax year, a revocation notice generally needs to be lodged before 1 April 2014;

Consolidated Groups
A consolidated group will take effect from the beginning of an income year providing an election is made within 63 working days of the beginning of that income year;

Rollover Relief
For those affected by the Christchurch Earthquakes, if you are seeking to rollover depreciation recovery income an election must be made with the filing of the tax return until the suspended depreciation recovered has been applied to replacement assets.

► For more year-end planning - download a copy of our BDO Year-End Tax Reminders

POLICY SNIPPETS

KEY SNIPPETS OF CHANGES AND UPDATES IN THE WORLD OF TAX POLICY AND LEGISLATION

The Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014 received Royal assent on 27 February 2014. The Act deals with a number of matters including significant changes to the treatment of foreign superannuation, extensions/amendments to the Christchurch earthquake tax relief measures and changes to the specified mineral mining rules.

Further information on the new rules applying to foreign superannuation from 1 April 2014, including details on the 15% transitional option applying to foreign pension transfers made or applied to be made prior to 31 March 2014, can be found online: http://taxpolicy.ird.govt.nz/publications/2014-fs-foreign-super/overview

The Convention on Mutual Administrative Assistance in Tax Matters is in force effective from 1 March 2014.

The Convention will allow Inland Revenue to request information from other tax authorities overseas and seek assistance in collecting outstanding debts from people who move overseas. It will also enable foreign tax authorities who are a party to the Convention to request the same information/assistance from Inland Revenue.

For more information see the media statement http://taxpolicy.ird.govt.nz/news/2014-02-28-convention-tax-assistance-enter-force#statement

Inland Revenue has released an updated version of the Public Rulings work programme 2013/14 (as at 7 March 2014). Some changes have been made to projected consultation and finalisation dates for existing projects to reflect present progress (including extensions to comment deadlines and late submissions received).

Of note is that a new QWBA (Questions We Have Been Asked) project giving the Commissioner's view on whether some arrangements are tax avoidance has been added.

For a copy of the work programme see http://www.ird.govt.nz/resources/e/8/e87b700041357664806de1fe04fb91e3/download-pr-work-programme-2013-14.pdf

The Student Loan Scheme Amendment Act 2014 received Royal assent on 7 March 2014. The legislation allows arrest warrants to be issued for persistent student loan defaulters who attempt to leave the country and makes some adjustments in the method of calculating repayment obligations to speed up repayments from borrowers living overseas.

The legislation also extends the power of the Inland Revenue to obtain a borrower's contact details from third parties if sharing this information is authorised by legislation, and makes it a criminal offence for borrowers living overseas who are in default of their repayment obligations to knowingly fail, or refuse, to make reasonable efforts to pay.

For more information see the media statement http://taxpolicy.ird.govt.nz/news/2014-03-07-student-loan-bill-passes#statement

Taxation (Annual Rates, Employee Allowances and Remedial Matters) Bill is with the Finance and Expenditure Committee. Matters covered in the bill include: the tax treatment of employee allowances; employer-provided living accommodation; the extension of the thin capitalisation rules; immediate tax deduction for capital expenditure incurred for the purpose of applying for the grant of a resource consent, patent or plant variety rights; and land-related lease payments.

For more information see http://taxpolicy.ird.govt.nz/bills/176-1

Tax Administration (Financial Statements) Order 2014 LI 2014/69 is a new Order in Council made on 10 March 2014 which sets out minimum financial reporting obligations for medium-sized companies from 1 April 2014.

For more information see the Minister of Revenue's media statement http://taxpolicy.ird.govt.nz/news/2014-03-13-changes-financial-reporting-requirements#statement

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