Backing precision

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TAX CHANGES CONTINUE APACE

In this edition of Tax Today we highlight a number of important tax changes which are currently in the reform pipeline.

Changes such as the so-called bright line test on land transactions and non-residents investing in real property are imminent with an expected application date of 1 October 2015. Similarly the tax credit allowing a cashing up of R&D losses is at select committee following its first reading.

The proposed reform of non-resident withholding tax (NRWT) and approved issuer levy (AIL) is at an earlier stage of consultation but warrants close attention given the potential impact on New Zealand's future cost of capital.

Tax remains a complex subject particularly in relation to overseas investments which are subject to a company reorganisation. These may have a tax preference in the overseas market but a different outcome in New Zealand.

The recent spin-off in Australia by BHP Billiton is a useful reminder of the need to pay attention to the New Zealand tax consequences of such reorganisations.

As always we are here to help so don't hesitate to contact your BDO adviser if there is any tax matter which is concerning you. We love to get your comments, so if you would like to let us know your thoughts on these articles, ideas or suggestions for future articles, please feel free to email them to editor@bdo.co.nz

Regards,

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IN THIS ISSUE

BRIGHT-LINE TEST ON RESIDENTIAL PROPERTY

Consultation is being sought on the proposed two year bright-line test for sales of residential property. The basic premise is that all gains on the sale of residential property which are sold within two years of being acquired will be taxed as income unless an exemption applies.

The exemptions are limited to property which is:

- the main family home;
- sold recently after it was acquired through an inheritance; and
- sold as a result of a relationship split.

New definitions of "residential land" and "main home" are proposed. There is to be only one "main home" being the one used mainly as a residence by the person and any member of the person's family living with the person and with which the person has the greatest connection. If a Trust owns a home and the settlor also owns a home, the exemption can only be claimed once.

It is proposed that losses generated as a result of the bright-line test are to be ring-fenced meaning they cannot be offset against other income but can be offset against similar residential property sales.

A specific anti-avoidance provision is proposed to capture gains made on the sale of shares in a company owning land where the purpose or effect of selling the shares is to defeat the bright-line test.

The two year test will be based on an acquisition date being the date the title is registered with the purchaser at the Land Transfer Office. However the date of disposal is to be the date a contract to sell the property is entered into by the vendor.

Submissions close on 24 July 2015. The bright-line test is due to apply from 1 October 2015.

For more information, please contact your local BDO adviser or contact us via the BDO New Zealand website.

IRD NUMBERS TO BE PROVIDED ON LAND TRANSFERS

Post 1 October 2015 both the vendor and purchaser of land will be required to provide an IRD number when ownership in land is being transferred. This will be part of the conveyancing process required by the Land Transfer Act 1952.

In addition to obtaining an IRD number a non-resident will be required to open a bank account in New Zealand and supply a tax identification number from their home country.

The obligation to open a bank account ensures that the non-resident is subject to compliance with AML and CFT legislation which the bank is required to review before allowing a bank account to be opened.

The provision of the home country tax identification number will allow a greater sharing of information between the relevant tax authorities if required.

The Taxation (Land Information and Offshore Persons Information) Bill had its first reading on 25 June 2015 and has been referred to the Finance and Expenditure Committee.

NEW DOUBLE TAX AGREEMENTS

NEW DTAs HAVE BEEN SIGNED WITH CANADA AND SAMOA.

The new DTA with Canada came into force on 26 June 2015 and replaces the previous 1980 agreement. Under the new agreement, the withholding tax rate on dividends falls from 15 per cent to a maximum of 5 per cent for an investor who holds a minimum of 10 per cent of the shares in the dividend-paying company.

The withholding rate on royalties has been lowered, from 15 per cent to 10 per cent generally, with a further reduced rate of 5 per cent for royalties on copyright, computer software, and other specified items. The withholding rate on interest payments drops from 15 per cent to a maximum of 10 per cent.

The new withholding tax rates will apply from 1 August 2015.

For New Zealand income tax, the new agreement applies to income years beginning on or after 1 April 2016, and for Canadian income tax, it applies to income years beginning on or after 1 January 2016.

The DTA with Samoa was signed on the day of the historic rugby test between the All Blacks and Samoa in Apia and replaces the previous Tax Information Exchange Agreement.

PROPOSED CHANGES TO THE NRWT & AIL

Inland Revenue have released an "issues paper" addressing concerns with New Zealand's NRWT and AIL rules. The paper is part of a consultation process aimed at updating and strengthening the withholding tax rules for related-party debt.

There are three important proposals open to consultation:

- The treatment of interest for NRWT purposes should be matched with the treatment under the financial arrangements (FA) rules.
- Associated party lending should not be able to be structured to take advantage of the AIL regime.
- The branch exemption from NRWT should be restricted.

The paper explains these proposals as follows:

1. Timing Mismatch

At present a liability for NRWT on interest is only triggered when the NZsourced interest is paid or deemed to be paid. On the other hand a deduction for the interest expense may be available on an accruals basis under the FA rules.

The related definitions of "payment" for NRWT have not changed since 1983 and it has been relatively easy for taxpayers to claim a deduction for interest under the FA rules but to defer the liability to the NRWT by not paying the interest.

To address this mismatch IR propose to:

- widen the definition of "money lent" to include an amount lent to a resident by an associated non-resident under which the resident incurs FA expenditure.
- calculate the amount of interest (NRPI) to bring it into line with how FA income is calculated.
- crystalise the NRWT liability on an accruals basis where payment would otherwise be deferred.

2. Preventing associated persons accessing AIL

The approved issuer levy ("AIL") rules were introduced to allow a levy of 2% to be paid on interest that would ordinarily be subject to NRWT.

The AIL was particularly useful when the non-resident lender was unable to claim a tax credit in their home country or required the interest rate to be grossed up for withholding taxes. It is designed to lower the cost of borrowing from offshore in specific circumstances but is not available to a borrower and lender who are "associated persons".

IR are concerned that funding structures such as "back-to-back" loans through a third party bank are designed to access AIL rules when the interest payments should be subject to NRWT.

To address this three changes are proposed:

- NRWT should be paid when NZ-sourced interest is paid to a third party, if it is part of an arrangement for that third-party lender to be provided funds by a non-resident who is associated with the resident borrower.
- NRWT should be paid when interest is paid to a non-resident who is not associated with the borrower under the normal association rules, but who is part of a "group of persons" who are acting together and would be associated with the borrower if they were a single entity.
- A third proposal intends to deal with the improper substitution of AIL for NRWT on interest to related persons. The suggested solution is to limit AIL to loans which are either to or from a financial intermediary, or raised from a group of 10 or more non-associated persons.

3. Restricting branch exemptions

The NZ income tax legislation currently has exemptions for interest payments that are made by foreign branches of NZ companies, or are made to foreign companies with NZ branches.

The concern of officials is that the wide scope of both exemptions means that certain interest payments are exempted in a way that is not consistent with the policy intention.

IR propose:

- to limit the existing offshore branch exemption so that interest paid by the offshore branch of a NZ resident is subject to NRWT or AIL to the extent that the interest is paid on money which is lent to a NZ resident.
- to limit the onshore branch exemption so that it only applies to interest that is received by a non-resident in connection with a business which is carried on through a fixed establishment in NZ.
- to allow members of NZ banking groups to use the AIL on interest payments to their non-resident associates which would otherwise be adversely affected by the suggested restrictions to the offshore and onshore branch exemptions.

What happens next?

Draft legislation is expected to be released later this year with a view that any changes would apply from the second half of 2016. Transitional rules are likely to apply to existing loans which would no longer meet the AIL status under the new rules.

These proposals will have a significant impact on both the NZ borrower and the non-resident lender. Any party likely to be affected should monitor the developments and review the potential impact on their funding requirements.

OVERSEAS COMPANY REORGANISATIONS

A proposed "spin-off" by Melbourne-based BHP provides a timely reminder that overseas company reorganisations can create unfortunate (and sometimes unforeseen) tax implications for a NZ shareholder.

Such company reorganisations could be called a number of things - e.g. spin-offs or demergers and NZ shareholders and their tax advisers need to understand the nature of the reorganisation in order to determine the appropriate tax treatment in NZ.

Put simply the NZ tax implications arising from overseas company reorganisations and transactions can often be very different from the tax treatment for shareholders in the country where the company is based or incorporated.

For example, just because shares issued as part of an Australian company spin-off might be tax-free for an Australian shareholder, it doesn't mean it will be tax-free to a NZ shareholder. Different terminologies and differing tax regimes between countries don't help.

NZ has a very broad definition of dividends which captures all types of cash and non-cash dividends and distributions where there is a transfer of value.

In short, care is required.

BODIES CORPORATE & GST

There has been uncertainty for some time as to whether bodies corporate could register for GST purposes. Although IR's view has fluctuated over recent years, new legislation is currently before Parliament and is intended to have the following effect:

1. The term "body corporate" will have the same meaning as in the Unit Titles Act 2010, but for the purposes of the GST legislation it will not include a body corporate of a retirement village which is registered under the Retirement Villages Act 2003.
2. A body corporate which is already GST registered will have that position "protected", and can stay registered if it wants to.
3. GST registration will be optional for most bodies corporate (supplies by a body corporate to its members are ignored for the purposes of the mandatory registration rule only).
4. Should a body corporate choose to register, the registration cannot be backdated, and an output tax liability will be imposed in respect of funds held by the body corporate at the time of registration. This rule is intended to deny a tax advantage from claiming input deductions from the application of levy income which was not subject to GST.
5. There will be a four year lock-in period to stop bodies corporate from continually changing their registration status.
6. If a body corporate subsequently deregisters, the value of the common property on deregistration will be treated as nil. This is in contrast to the general rule which states that a registered person is liable for output tax on the market value of the assets retained on deregistration. Note the body corporate would not be refunded any GST paid on its funds held at the time of deregistration.

If a body corporate is contemplating whether or not to register for GST, it will need to factor in the related compliance costs, the one-off adjustment required upon registration, how its forecast income and expenditure would be impacted by being registered, and what the implications would be for the unit owners.

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

Rio2016 PARALYMPIC GAMES

RESEARCH & DEVELOPMENT TAX CREDIT

Some important changes to the tax rules for research & development expenditure are being considered by the Finance & Expenditure Committee. The most significant proposal is the proposed "cashing up" by way of a tax credit where a company undertaking research & development is incurring tax losses.

The proposed changes are as follows:

1. Start-up companies will be able to claim up to 28 percent (the current company tax rate) of their tax losses which arise from research & development expenditure in any given year.
2. There are a number of eligibility requirements. The main requirements are that the company must be a loss making company resident in NZ, with a sufficient proportion of expenditure on research & development. Listed companies are excluded, as are qualifying companies and look-through companies.
3. The amount that can be cashed out will be the smallest of the following amounts:
   a) The cap which applies to the relevant year - $500,000 for the 201 5-16 year, increasing by $300,000 over the next five years to $2 million.
   b) The company's net loss for the year.
   c) The company's total research & development expenditure for the year.
   d) 1.5 times the company's labour costs for research & development for the year.

The definition of research & development expenditure that will apply for the cash-out rule will be more restricted than the definition which applies to the current income tax deduction provisions for research & development. Expenditure on certain activities and some types of expenditure are excluded.

Because the cash-out will be administered through the tax system, it will be delivered in the form of a tax credit for the year in which the loss arose. In other words, it will not be possible to cash out a loss in a later year.

Losses which are cashed-out are extinguished. A cashed-out loss is effectively like an interest-free loan from the Government.

It is intended to provide a temporary cash-flow timing benefit, and if the business makes an untaxed return on its research & development, it will be required to repay some or all of the amounts cashed out.

In particular, the proposed legislation specifies that cashed-out payments should be repaid (and corresponding losses reinstated) if any of the following events takes place:

1. The company disposes of or transfers research & development assets (i.e. intangible property, core technology, intellectual property, or know- how).
2. The company fails to meet an eligibility requirement.
3. The company migrates.
4. The company is liquidated.
5. The company amalgamates with another company.
6. More than 90 percent of the company has been sold since the company first cashed-out research & development tax losses.

New deductions would reinstate corresponding losses, which would then be available to offset future income. The proposed rules will apply to income years beginning on or after 1 April 2015.

Other proposals in the current tax bill are primarily targeted at "black hole" research and development (R&D) expenditure. This is where business expenditure is not immediately deductible for income tax purposes, but also never becomes part of the cost of a depreciable asset for income tax purposes. This means that the expenditure may never be deductible.

If you would like to find out more about the above proposed changes to the research & development tax rules, please contact your BDO adviser.

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