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# NEWSLETTER NOV 2020 — JAN 2021

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## Election outcome and 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 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.

# Deductibility of Healthy Homes costs

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 and 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 move 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 and 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.

# Is the grass greener over the ditch?

Australia has recently released its 2020-21 Federal Budget where they plan 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 17 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.

## What is revenue?

"Revenue means the total amount of money a business has earned from its normal business activities, before expenses are deducted" (Work & Income, July 2020).

This core definition has been applied by thousands of businesses to apply for the Government's wage subsidy scheme that was implemented due to the COVID-19 pandemic. Whether a 30 percent or more reduction in revenue for the original wage subsidy, or a 40 percent or more reduction for the wage subsidy extension, quantifying the reduction in 'revenue' was a key hurdle to be eligible.

With the potential for wage subsidy applicants to be audited, documenting the basis for an application and how the eligibility criteria have been met is critical. In some cases, confirming eligibility should be straightforward. Retail stores, restaurants, cafes and bars that had to shut their doors overnight should be able to demonstrate a clear drop in 'revenue'.

However, for other industries it may not be as straightforward. In some cases, the time at which an invoice is issued for GST purposes is different to the point in time at which income is recognised for tax and / or accounting purposes.

Take for example the construction industry where jobs are invoiced based on specific milestones. If invoices were raised during the lockdown, for work completed prior to the lockdown, then measuring the change in revenue based on 'invoicing' would not provide a fair reflection of the effect

It goes both ways. The different ways the revenue test is able to be interpreted, and not knowing what the audit process will comprise gives rise to uncertainty. A suggestion is to ensure that the method used to calculate the revenue reduction should be logical within the context of a particular business.

## FBT on vehicles during lockdown

FBT applies to vehicles based on "availability" rather than actual use. As such, Inland Revenue has confirmed that if an employee had the right to use a motor vehicle for private purposes, then this will attract an FBT liability as normal – regardless of whether the employee actually used the vehicle.

With the benefit of hindsight, employers who took the pro-active step of engaging with their employees to agree restrictions regarding the use of company vehicles during the lockdown period could have reduced their FBT cost. However, understandably, FBT was not at the forefront of businesses' minds as attention was on likely focussed on more important issues such as cashflow and customer relationships.

Let us hope there is not another lockdown, but this could be something to think about if there is.

**If you have any questions about the newsletter items, please contact us, we can advise you**

## Newsflash: Small business cashflow loan scheme

The re-elected Government has announced on 9 November a 3-year extension to the Small Business Cashflow Loan. This gives small businesses a better window to both borrow, and repay the loan, and increases the interest free period. A summary as follows:

- Interest free period is extended from one to **two years**
- The terms of use of the loan has been broadened and now **includes capital expenditure**
- Applications can now be made until **31 December 2023**

**This is good news for those of our clients who have been affected by Covid-19 restrictions. These terms will be extended to those who have already received the loan.**

## Goodbye to cheques

As we advised in our newsletter last year, improved applications for safer online payments from your smartphone or tablet has meant that processing cheque payments has become a rather laborious task. Therefore banks and big entities have decided to stop using and accepting cheques.

IRD and ACC have become increasingly digital in the way they work and they have stopped accepting payments by cheque as most customers are paying their taxes and levy fees electronically. It was announced that from 1 March 2020 they no longer would accept payments by cheque.

Kiwibank has gone cheque free and they no longer issue or accept cheques since 28 February this year.

Now ANZ and Westpac have advised their clients that they will stop issuing and accepting cheques from **31 May 2021** and **26 June 2021** respectively. BNZ will phase out cheques by **July 2021**.

**The Team at Urlich Lander wishes you a very Happy Holiday season and a peaceful, prosperous (and hopefully Covid free) New Year.**