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You versus your Trust

It is common from a layman's perspective to not appreciate the relevance of treating separate legal entities as separate. Where expenditure is incurred to derive income, it is typically deductible for income tax purposes to the person that derived the income. Documentary evidence should be held that reflects this connection to ensure the expenditure comprises an allowable deduction. The High Court recently considered this issue in the decision of *Wong v Commissioner of Inland Revenue* (2018).



In *Wong v CIR*, the taxpayer was an accountant by profession. He derived income from a consultancy business and two rental properties. He was also trustee of his family trust that derived rental income from a third property. Mr Wong financed both the consultancy business and rental properties through a number of loans and credit facilities in his personal name.

Despite reminders from Inland Revenue (IRD), Mr Wong failed to file personal income tax returns for the 2013 and 2014 tax years and IRD raised default assessments for those years of \$84,273.10 and \$39,549.65, including penalties.

Mr Wong disputed the assessments, contending that the correct tax position was \$951 in 2013 and nil in 2014, on the basis that interest deductions were available in respect of all three rental properties. IRD argued that interest was only deductible in respect of the two properties owned personally. However, the interest incurred for the trust property could not be deducted against his personal income as it had been incurred by the Trust, as owner of the property. To successfully challenge IRD's assessments in the courts, the

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onus of proof rests with the taxpayer to show how, and by how much, the IRD's assessments are wrong. With respect to the interest incurred in relation to the trust property, the TRA found in favour of IRD, emphasising that Mr Wong had failed to prove the outstanding debt and interest was paid in relation to properties owned by him personally.

The taxpayer appealed to the High Court, who found the TRA's decision correct in all respects.

A shortfall penalty, for taking a 'grossly careless tax position' was also upheld. Mr Wong contended that no shortfall penalty should apply

once tax losses are taken into account i.e., no cash tax liability existed due to his personal tax losses. However, shortfall penalties are calculated based on the net shortfall, as though tax is payable and the shortfall penalty was upheld.

From a commercial perspective, it can make sense to stand back and look at a group of entities as though they are a single person, especially when they are economically owned by a single person, however, IRD and the Courts do not take the same approach.

GST and land sales

In 2011 the GST Act was amended to prescribe that a supply of land between two GST registered parties was subject to a rate of 0% if the land was to be used by the purchaser to make taxable supplies and not as a principal place of residence.



Given the change reduced the GST rate to 0% it is fair to assume it should have simplified how GST applies, i.e. there wouldn't be any. However, in practice the change continues to cause problems both from a contractual and technical perspective. This led to Inland Revenue (IRD) issuing additional guidance in 2017. However, problems persist. We have outlined two examples below.

Under the GST Act, a purchaser is required to notify the vendor of their circumstances so that the vendor can establish whether or not to zero-rate the sale. In practice, this occurs by completing Schedule 1 of the Auckland District Law Society (ADLS) Sale and Purchase (S&P) agreement. However, there are instances where the schedule is not completed at all, in which case there is no 'agreement' between the parties regarding how GST applies.

If a GST registered purchaser does not complete the schedule and a vendor mistakenly charges GST at 15% because they assume the purchaser is non-registered, the purchaser will understandably apply to IRD for a GST refund. If IRD review the transaction and determine it

should have been zero-rated IRD will decline the refund. Instead, the purchaser will need to seek a refund from the vendor. The vendor will also need to apply for a refund (of the GST) from IRD, to fund the repayment to the purchaser.

Another scenario is where Schedule 1 of the S&P has not been completed at all and the vendor incorrectly zero-rates a sale on the assumption that the purchaser is GST registered etc. In this situation, GST will need to be paid, but there is currently uncertainty regarding who is liable. A provision exists that deems the purchaser to be liable if a transaction has been incorrectly zero-rated. However, it is unclear whether this provision applies in all situations or only when the vendor and purchaser agreed what the GST treatment should be, which is later found to be wrong. If the vendor is held liable and the price has been expressed in the S&P as "including GST", the vendor is worse off. If the purchaser is held liable and the S&P was "including GST", it becomes a question of whether the purchaser can seek a partial refund of the purchase price from the vendor to fund their GST liability.

It is extremely important to ensure the S&P is complete and correct. Costly mistakes can be avoided simply by following due process. If you are unsure, please ask your advisor.

When is a gift not a donation?

If an individual pays "...a monetary gift of \$5 or more..." to a charity they are able to claim 1/3rd of it back from Inland Revenue (IRD). Prior to 1 April 2008, individuals could only claim donations of up to \$1,890, i.e. a refund of \$630. The

coalition Government at the time removed this limit and increased the threshold to the amount of taxable income, to incentivise individuals to give charitably.

For the average New Zealander, limiting donation claims to the amount of a person's taxable income is of no consequence. However, some high net worth individuals make donations that exceed the amount of their taxable income, thereby entitling them to large refunds.



cash payment, provided that it was a gift of a specific sum and was not a chattel or property item. Judgement was upheld for Mrs Roberts.

For example, a large donation could be made to help fund an important capital project of a charity, such as the construction of a new building for the homeless. The question then becomes how to structure a large donation, to ensure a donation rebate can be claimed. The problem lies in the legislation itself. Although the regime is to incentivise charitable giving, the legislation can be narrow in scope. The donation claim is restricted to monetary gifts made in an income year, whilst assets, such as "food" donated to the homeless, does not qualify for the tax credit.

The High Court decision in *Roberts v Commissioner of IR* examined a donation rebate that was in the form of a loan forgiveness. Mrs Roberts had made a cash loan to a charity of \$1.7m. The loan was subsequently being forgiven across multiple years and claimed as a donation rebate. IRD considered that a 'debt forgiveness' was not a charitable gift within the meaning of the current legislation because it was not a 'cash' gift. Judge Coleman decided in favour of Mrs Roberts and confirmed that a monetary gift did not require

The forgiveness approach is no different, for example, to Mrs Roberts making the loan and then making cash donations in future years that are used by the charity to repay her loan. In substance, cash has been paid by a private individual to a charity – being the purpose of the regime.

In a surprise move, when the Taxation (Annual rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill was reported back from the Finance and Expenditure committee (FEC) on 18 January, IRD had included a recommendation that the current legislation be amended to prescribe that donations need to comprise a "gift of money", thereby legislating against the decision in *Roberts*. By recommending the change at such a late stage of the enactment process, it skips the public consultation phase. IRD have justified the change by asserting that the 2007 re-write of the Income Tax Act changed the meaning, and they are merely changing it back.

Rather than accepting IRD's view, it would be nice if the FEC had looked at the issue more 'charitably'.

Winding up a company



If a company does not file its annual return with the Companies Office, it may be struck off from

the Companies Register. This is sometimes used as a 'short-cut' method, rather than completing the short-form company liquidation process.

However, this approach comes with some risks, for example, if a company is struck off the register whilst it has tax credits owed by Inland Revenue (IRD), the tax refund is effectively forfeited and will not be paid to the company nor its shareholder(s) unless the company is reinstated.

Similarly, if a struck off company is still named as the owner of land (on the title), the company has to be reinstated in order to transfer the land to its correct owners and then wound up again.

Although the process of winding up a company can be lengthy, to minimise risk for both the

business and its stakeholders it is recommended that the correct procedure is followed.

The process should always be commenced with a special shareholders resolution, which provides legal evidence that the majority of shareholders agree to the wind-up. It represents the point from which capital gains may be distributed tax free and is a commonly requested by IRD if they happen to review the wind-up process.

Any outstanding company liabilities are then satisfied, including trade creditors and anything owed to related parties. Surplus assets are distributed to shareholders, ensuring any legal formalities are observed depending on the type of asset (e.g. updating the land registry for any land / buildings).

For tax purposes, distributions to shareholders may be non-taxable to the extent they are comprised of share capital or capital gains, however excess amounts may comprise taxable dividends to the shareholders.

The company should complete its final GST and income tax returns (etc.), pay any outstanding tax liabilities and then de-register with IRD. A request is also made to IRD to provide written approval for the company to be removed from the companies register.

With no assets or liabilities, the company bank account can be closed before the final stage of passing a further shareholders resolution resolving to make an application to the

Companies Office to remove the company from the Companies register. The Companies Office gives public notice of its intention to strike the company off in the New Zealand Gazette. Provided no objections are received within 20 working days from the date of the notice, the company is struck off the register.

Although the process sounds prescriptive, incurring the cost of having it done correctly could save money in the long run.

Snippets

GST on low value imported goods



GST is intended to be a broad-based tax applying to goods and services consumed in NZ, however under the current system not all goods and services are captured. Specifically, GST is not currently collected on imported goods worth \$400 or less. Historically, it was thought that the administrative cost of collection would outweigh the tax revenue collected, however the import market has grown giving rise to increasing concern NZ suppliers are disadvantaged in comparison to offshore suppliers.

Following in the footsteps of recent Australian law changes, a Bill was introduced into Parliament in December 2018, the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters), that seeks to level the playing field.

The Bill, intended to be effective from 1 October 2019, proposes to apply GST to goods valued at \$1,000 or less (excluding tobacco and alcohol) that are delivered to a NZ address from overseas. Offshore suppliers will be required to return NZ GST if their total supplies to NZ exceed \$60,000 in a 12-month period.

So what does this mean for NZ consumers? They will likely have to pay GST on low-value goods imported from overseas, while NZ businesses are now on a more level playing field with their overseas competitors.

Sugar Taxes

With obesity becoming an ever increasing problem in New Zealand, there is regular debate regarding the effectiveness of a sugar tax to curb the problem. There is a lack of consensus on whether such a tax may be beneficial, yet sugar taxes are nothing new.



100 years ago in 1919, with the First World War nearing conclusion, politicians in the United States decided that taxing ice-cream sodas, sundaes, juices, lemonades and other sugary drinks would offset the tax revenue lost from alcohol sales once the nationwide prohibition came into effect.

However, one year after introduction of the sugar tax, following the conclusion of the war, the tax was scrapped. The USA still faced record levels of war debt, yet the soda tax was so unpopular with the American people that it wasn't a viable option.

Although the 1919 soda tax did not have health objectives in mind, it is reasonable to conclude that soda was not something the American people wanted their politicians messing with.

After 100 years, the situation in New Zealand is only getting worse with 32% of adults considered obese, what are our options? During the First World War, rationing was a way to ensure people got what they "needed"...

Rental Properties

There have been a number of changes to legislation relating to rental properties.

The timeline for the first of these changes is fast approaching.

By 1 July 2019, all rental properties are required to have insulation under the floor (where possible) and in the ceiling.

If you are still to complete this work on your rental property we recommend that you start on this process now as based on stats provided, there are many properties still to complete this work.

Further regulations have been drafted which will require additional improvements to rental properties. These are still to be approved by Cabinet.

As drafted they include:

- Have a heater that can heat the main living room to 18 degrees Celsius
- Have ceiling and underfloor insulation that either meets the 2008 Building Code insulation standard or for existing ceiling insulation, have a minimum thickness of 120 millimetres.
- Kitchens and bathrooms will be required to have extraction fans or rangehoods.
- Install a ground moisture barrier to stop moisture rising into the home where there is an enclosed subfloor space.
- Have adequate drainage and guttering to prevent water entering the home
- Block draughts that make a home harder to heat.

In addition to the above Healthy Home Standards, there are also Income Tax changes in respect of rental properties which apply from 1 April, 2019.

The legislation is intended to disallow losses from rental properties being deducted from investors other income such as salary or wages, to reduce their tax liabilities.

Any losses from rental properties, will be carried forward until the property makes a profit.

If you are thinking of carrying out any maintenance work on your property, it may be better to get this completed before 31 March, 2019, than after.



End of Financial Year

31 March 2019 is fast approaching, and generally marks the end of another financial year.

We will be sending out our normal Questionnaires and Checklists in early April as a reminder of what is required when you are putting your records together.

As we are now required to comply with the Anti Money Laundering Legislation, we will also be asking all clients, who have not already done so, for a copy of photo ID such as a Drivers Licence or Passport, plus a document showing proof of address which is not more than three months old.

For those clients keen to bring their work in early for 2019, we have listed below the main records which we generally require:

- Schedule of Stock on Hand at balance date, detailing whether the value is GST exclusive or inclusive.
- Copy of a Bank Statement at 31 March 2019, with a Bank Reconciliation print out if you are using computer software
- A Schedule of Accounts Receivable detailing customers that owe you monies
- A Schedule of Accounts Payable detailing accounts for March, 2019, that you will pay in April, 2019.
- Wages Schedule Summary, with details of any annual leave taken by staff within 62 days of 31 March
- Copy of GST Return to 31 March, 2019, with your calculations
- Copies of Loan Statements as at 31 March, 2019.
- Details of any Fixed Assets purchased or sold, with copies of any relevant Hire Purchase Agreements.
- Details of any other income you may have earned such as Interest, Dividends etc.

The more information that you can bring in with your initial records, the better that we can complete your Annual Accounts and Tax Returns.



If you have any questions about the newsletter items, please contact us, we are here to help.