NEWSLETTER

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Tax Working Group Interim Report

The Labour Government established the Tax Working Group ("the Group") in January 2018 to review the existing New Zealand tax framework and to provide recommendations for improvements to the fairness, balance and structure of the tax system over the next 10 years. An Interim Report was released on 20 September 2018, to provide interim conclusions on twelve areas of concern for New Zealanders, based on the thousands of submissions received during their two-month public consultation.

One of the most topical issues is the potential introduction of capital gains tax. The report discusses potential design options for a capital gains tax, but the report makes it clear that the Group is still forming its view on whether to recommend a capital gains tax at all. Broadly, a capital gains tax could apply on a realised basis as assets are sold or on a deemed return basis. Assets captured would include interests in land, intangible property, income-earning assets not already taxed on sale, and shares in companies. The Group confirms that family homes and personal assets such as cars, boats and jewellery should be excluded.

Another key area discussed is the taxation of retirement savings. The Group considers high-income earners are likely to be saving adequately, hence they have suggested a package of modest retirement saving incentives aimed at middle and low-earners. This includes the removal of Employee Superannuation Contribution Tax (ESCT) of 3% for employees earning up to $48,000 per annum, and a five percentage point reduction for each of the lower PIE rates applying to KiwiSaver accounts.

On the topic of international tax, the interim recommendation is to 'wait and see' what approaches are adopted by other countries. The Group does not want to suggest a regime that could potentially cause negative retaliatory action from other countries, risking harm to our export industries.

The Group is also "weighing up their options" for the current rates and thresholds for personal income tax. The focus for personal income tax is ensuring compliance by the rising number of self-employed.

For business, the Group recommend maintaining the current company tax regime and rates, including retention of the imputation system. They have not recommended the introduction of a progressive company tax, or an alternative basis of taxation for smaller business, instead focussing on providing support for smaller businesses through simplification of the tax compliance process. For example, by increasing the provisional tax application threshold and the $10,000 de minimis threshold for automatic deduction of legal fees.

The Group was specifically excluded from considering an increase in the GST rate, however it received many public submissions on a potential reduction. After analysing the effects this would have, the Group does not recommend a reduction, nor removal of GST from certain products such as food and drink, on the basis that such measures would be poorly targeted and that more effective ways are available to provide assistance to low and middle income families.

In addition to these main areas, the Group considered a few more specific topics, including recommending the retention of the 17.5% rate of tax for Maori Authorities, and extending the rate to subsidiaries of Maori Authorities.

The views expressed in the interim report are not final, and the Group are welcoming feedback from all New Zealanders before the final report is released in February 2019.

Payday filing

The way employers report payroll information to Inland Revenue (IRD) is changing. From 1 April 2018, IRD introduced a new electronic reporting system, providing employers the option of filing payroll information every payday. From 1 April 2019, the new system will be compulsory for most employers, so it is imperative business owners get to grips with the new rules to avoid the risk of non-compliance.

Under the new payday filing system, the information must be reported every time employees are paid, which could be complex for businesses with a combination of employees paid weekly, fortnightly and monthly.

From 1 April 2019, the new system will be mandatory for any NZ employer who withholds more than $50,000 of PAYE and Employer Superannuation Contribution Tax (ESCT, e.g. Kiwisaver) per year. Paper filing will remain available for smaller entities who do not exceed this threshold, although they may also opt in.

The details submitted to IRD will remain substantially the same, with additional information required in respect of ESCT payments, the pay cycle frequency, pay period start and end dates, and the payday date. There will also be amendments to the way information is collected for new employees, allowing electronic onboarding for new starters.

IRD's electronic system supports three ways of collecting the employment information. The most straightforward option is direct filing from compatible payroll software, bypassing the need for files to be uploaded through the 'myIR' system. Alternatively, information can be submitted electronically or manually through the employers online 'myIR' account.

Generally, payday filing will require employment information to be submitted within two working days of each payday. For a business with a combination of employees paid both monthly and fortnightly, the filing deadline will be within two working days of both the monthly and fortnightly payday. However, for IR56 taxpayers, or employers below the $50,000 threshold, the deadline will be extended to within 10 working days of each pay date, with an option to submit a single monthly report.

Despite the increased reporting frequency required by payday filing, PAYE payment dates and methods of payment will remain the same. This means employers will continue to pay PAYE monthly or twice monthly, as they currently do.

Although the increased reporting frequency may appear burdensome at first glance, there is an opportunity for payday filing to reform payroll processes, becoming an integral part of the general accounting system rather than an additional monthly task. This integration will work best for software systems that can upload directly to IRD. Some employers may need to upgrade their existing payroll systems and procedures to ensure compliance by the mandatory deadline, hence, it is important that employers start considering the impact the changes will have now.

Engagement

Modern HR practice considers people managers to be at the forefront of the employee experience, with employee engagement stemming directly from an employee's relationship with their manager. It is often said that people don't leave companies, they leave managers. Hence, the ability for organisations to foster an employee experience leading to loyalty, retention, and business success hinges on the relationship and connection between management and their employees.

Employee engagement is vital in any organisation to preserve the right talent needed to acquire, serve and retain business. However, there is a common misconception that this engagement is determined by financial remuneration and perks alone. Recent trends, supported by research conducted by Gallup, have shown a fault with this model, demonstrated when employees receive employment offers from elsewhere. Commonly, if they believe the other employer will value them more on a personal level, they will leave, even if it is for less financial reward. This suggests that employers are not focussing on areas that employees truly value. It is evident that employee engagement is no longer created by perks, rather is it created through a culture driven by trust and approachable and personable leaders.

Traditional hierarchical management structures can create blockages to engagement, whereby a lack of personal and approachable leaders breeds a fear-based culture. This can make employees feel as though they are treated as a skill set, rather than a person. Similarly, if employees do not feel connected to the outcomes of their work and the strategy of the organisation, they are unlikely to be engaged. This is where it is important that managers help employees to make the connection between their work and the organisation's mission.

In a time where many of our work functions are becoming increasingly automated, managers are thought to have more time than ever to interact with their employees. The key is to use this time for more meaningful interactions. The transition from traditional management styles, to one focused on stronger relationships and people development, may pose a challenge for managers unequipped to deal with changing expectations. However, it is vital that management adapt to avoid negative effects on employee engagement.

As our workplaces offer increasingly flexible work options, the opportunity to maintain face-to-face communication is also threatened. This will challenge organisations to consider how their workspaces and work practices can be better designed to facilitate interpersonal relationships between managers and employees. However, in order for managers to fulfil these new expectations it is critical that managers are equipped with the skills necessary to be good relationship builders and behavioural leaders. Historically, management development has focused on "hard" skills. Yet, with ongoing advancements in technology and automation, organisations should renew their focus to developmental opportunities for managers.

Organisations that are committed to building deeper personal connections amongst employees are likely to see the benefits of increased commitment, job satisfaction, and productivity.

R&D tax incentive – framework confirmed

The Government has now released draft legislation prescribing how its R&D tax credit will operate. The key incentive is the introduction of a 15% R&D tax credit (increased from 12.5% in the draft proposals) applying to maximum expenditure of $120m, equating to a potential tax credit of $18m. Businesses can apply to exceed this expenditure cap if they can demonstrate NZ will derive a substantial net benefit from the R&D. The minimum R&D expenditure threshold has also been decreased to $50,000 per annum, from the original amount of $100,000, which will help smaller businesses access the regime.

As originally proposed, the new tax credit was to be non-refundable. During the consultation period requests were made for the new scheme to include a refund mechanism for early stage R&D intensive companies that commonly experience tax losses during their early years. The resultant cash flow problems can threaten their existence. The Government recognised that such firms are vital to innovation and the development of a diversified economy. Hence, for the first year of the new regime (1 April 2019 – 31 March 2020) the Government will allow tax credits to be refunded based on the limits prescribed within the existing tax-loss cash-out scheme, i.e. businesses can receive refunds providing at least 20% of their labour cost is R&D related, to a maximum eligible spend of $1.7m. At the new tax credit rate of 15%, this will provide a maximum refund of $255,000. For context, approximately only 350 businesses currently benefit under the current scheme. The Government recognise this is only an interim solution so they will continue to review the new regime, with revised rules for refunds expected from 1 April 2020.

A further welcome change is a widening of the definition of 'eligible R&D expenditure'. The initial Discussion Paper contained a narrow definition requiring the use of 'scientific methods'. There was concern that this would preclude tech sector businesses from accessing the regime, as the development of computer software or phone apps is not commonly based on 'scientific methods'. This has been addressed, with the revised definition based on the use of a 'systematic approach'.

The tax credit claims will be submitted alongside income tax returns. However, from the 2020/21 year, businesses will be required to attain pre-approval of their eligible R&D expenditure, which will be binding on IRD, providing businesses the ability to confidently forecast their future tax positions.

The changes to the regime reflect the Government's commitment to raise NZ's R&D expenditure to 2% of GDP over the next ten years, whilst making the regime accessible to a wider range of businesses.

Deductibility of bad debts

Many of the costs associated with running a business can be claimed as a tax-deductible expense, but not all. The Income Tax Act dictates that to be deductible, expenses must be incurred in the course of deriving assessable income, or in running a business.

Bad debts are one such example. Bad debts are real losses suffered by a business, arising when credit has been extended to customers who are ultimately unable to pay the amount owed. The timing of a bad debt can be subject to a degree of subjectivity. Hence, although they are commonly recorded as an expense in the financial statements after a certain period of time, there is no automatic right to a tax deduction. The default position in the Income Tax Act is to deny a deduction for a bad debt, except where the debt has been written off during the income year or certain other legal steps have been taken to formally release the debtor from payment.

Whether a bad debt deduction could be claimed was the subject of a recent High Court decision, Boon Gunn Hong v Commissioner of Inland Revenue [2018], where the taxpayer was ultimately unsuccessful.

The taxpayer was a barrister and solicitor working as a sole practitioner. He made loans of $50,000 and $122,280 respectively to two of his legal practice's clients, both of whom were facing financial difficulties. The court referred to them being made from a "benevolence on the conscience loan fund" intended to help clients facing financial difficulties. When the debtors became unable to pay, the taxpayer claimed a tax deduction for the bad debts in the 2011 year.

The Court denied the deduction on several grounds. Firstly, the Court considered the general principle requiring a connection between an expense and the income derived by the business. The taxpayer was not in the business of lending money nor was there a connection between the taxpayer's legal services business and the bad debts, hence the loans were not expenses incurred in deriving his assessable income.

Secondly, under the specific bad debt provisions, the taxpayer's own accounting procedures failed to show that the loans had been written off in the 2011 year. Furthermore, he had failed to establish that the debtors were legally released from making any further repayments. One debtor was only released from bankruptcy in 2013 and the other had not been adjudicated bankrupt at all.

The case had initially been heard in the lower courts, with the taxpayer charged shortfall penalties for taking a lack of reasonable care in forming his tax position. In addition to finding against the taxpayer, the High Court upheld the penalty, with the taxpayer also forced to pay the legal costs involved in taking the case to the High Court.

This case highlights the importance of ensuring the deductions claimed in your tax return are properly allowable under the Income Tax Act 2007. If you have any expenses that could possibly raise red flags it is important to take specialist tax advice to avoid the potentially costly consequences of mistakes.

Does your NZ family trust have UK tax obligations?

If your family trust has a 'UK tax connection' the trust might now be obliged to register with H M Revenue and Customs (HMRC) in the UK. The UK has recently introduced a Trusts Register and there will be a significant number of New Zealand family trusts which will need to register. The following article by Martin Riley of Sterling Tax Services explains which family trusts might be affected.

The reason for the introduction of the Trusts Register in the UK is to ensure that the UK complies with the Common Reporting Standard which is the worldwide initiative to counter tax avoidance. All participating countries (including New Zealand) are now collecting information about taxpayers which will be exchanged between tax authorities in order to ensure that taxpayers receiving overseas income are correctly taxed on that income in their country of residence.
Although most trusts on the UK Trusts Register will be UK constituted trusts, there will be some New Zealand family trusts which will be obliged to register. These will, broadly speaking, fall into four categories:

1. **Trusts which were established in New Zealand either before the settlor became resident here or within a period of 3 years after leaving the UK.**

Many UK migrants will have established a family trust soon after arriving in New Zealand and these trusts could be subject to the UK inheritance tax (IHT) regime. If you established a family trust within 3 years of leaving the UK permanently, then you should seek advice.
Even if the trust was established after 3 years it may also be subject to the IHT regime if you are unable to show that you are no longer domiciled in the UK – and it should be noted that you can still be domiciled in the UK years after you have left the UK if you regularly visit and maintain a close connection with the UK.
It should be noted that IHT liabilities can arise (a) when the trust was established; (b) on a subsequent 10 year anniversary; or (c) when capital is withdrawn. In many cases the liability may be NIL but there is still a duty to report to HMRC. The obligation to register the trust only arises where there is a tax liability.

2. **Trusts which have untaxed UK sourced income.**

These trusts will have a UK tax liability on their UK sourced income.

3. **Trusts which have UK interest and dividend income and a UK resident beneficiary.**

Normally a New Zealand family trust with UK interest and dividend income would not be subject to UK tax on the interest/dividend income derived in the UK. However, this exemption does not apply where there is a UK resident beneficiary.
If you have set up a typical family trust with children and grandchildren as beneficiaries and one of your children/grandchildren is resident in the UK (either working in the UK or doing their 'OE') then this may trigger a UK tax liability if the trust is invested in a UK company. This will apply even where there is no distribution to the UK resident beneficiary.
Any trust with a diversified investment portfolio is likely to acquire some UK listed shares and this could trigger the obligation to (a) pay some UK tax; and (b) register the trust in the UK. Does your trust have UK listed shares or UK sourced interest?

4. **Trusts which <u>acquire</u> UK listed shares (including UK investment trusts).**

The purchase of UK listed shares triggers Stamp Duty Reserve Tax and this, in turn, triggers the obligation to register the trust in the UK. Therefore, it would be much easier from a tax compliance point of view if the trust's investment adviser purchases shares in New Zealand or Australian unit trusts rather than investing directly into UK listed shares.

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Snippets

Royals in NZ

There has been no shortage of news about the Royal Family recently, particularly given Harry and Meghan's visit to NZ. Yet you may not know that in 1970 NZ was the location of the very first "royal walkabouts", designed to enable the Queen to meet the public.

The Queen has actually visited NZ ten times during her lifetime, so NZ could arguably be a favourite destination of the family! Despite their obvious good taste in countries, some of the guidelines and traditions followed by the Royals are quite unusual.

For example, the Royals may happily pose for 'selfies', but will never give an autograph due to the risk of potential forgery.

Strict heed is given to royal hierarchy, to the extent that Prince Philip commonly walks two steps behind the Queen to represent their rankings in the royal family. It's also frowned upon for 'lower' members of the family to go to bed before the Queen.

There are some equally unusual eating habits – the Queen has a 'no garlic' rule, as well as a family ban on shellfish. Also at meal times, guests are not allowed to continue eating after the Queen has finished.

The Royal trips to NZ seem set to continue, so it may be worth keeping these rules in mind in case you meet any of the Royals on their future visits!

Anti-Money laundering regulations

Since 2013, financial institutions, such as banks, have had to comply with Anti-Money Laundering regulations. These rules have now been extended to other businesses providing financial services, such as real estate agents, accountants and lawyers.

The regulations are designed to prevent criminals laundering money through legitimate New Zealand businesses and apply in a number of circumstances, predominantly where financial transactions are involved.

The rules require affected businesses to formally identify their customers and understand the true source of funds for every individual they interact with, before they can undertake certain work. This is likely to incur additional costs for affected businesses, but there is no way around it, and the fines for non-compliance outweigh the cost.

The extension of these regulations seek to ensure New Zealand continues to protect and enhance its reputation as a good place to do business and is meeting international standards. However, they may slow down the time it takes to get professional assistance.

MND Walk 2018

As a firm we support the Walk 2 D'feet MND which is held in November each year.
In addition to providing manpower and office support, we participate in the walk on the day.
Below is a photo of some of the team with Rocco the dog who entered in the dog parade and came away with a prize!
The day was a great success with face painting, the puppet and balloon man, a dog parade, a huge silent auction and music by the Kaimai Express band.

Thank you to everyone who supported this event and fundraiser.

Christmas Hours

The office will close for the Christmas break at 5.00 pm on Friday 21 December 2018 and re-open on Monday 14th January 2019.

We wish you all a happy and safe Christmas and New Year.

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