de Lacey & Associates Limited

CHARTERED ACCOUNTANTS

NEWSLETTER

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INSIDE THIS EDITION

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Clarity for property investors

In March 2021 the Government announced changes to the bright-line test and interest deductibility for residential properties.

Following the release of a discussion document in June, there has still been significant uncertainty regarding the specific details of how the new rules will apply. However, the government has now provided clarity through the release of draft legislation on 28 September 2021.

For the purposes of the legislation, a new term has been coined - "disallowed residential property" (DRP), which refers to those properties for which interest deductibility will be affected.

DRP's purchased before 27 March 2021 will have their interest deductibility phased out between 1 October 2021 and 31 March 2025, while those purchased on or after 27 March 2021 will be wholly denied the deduction from 1 October 2021.

However, if a property has had a code compliance certificate (CCC) issued on or after 27 March 2020 it will qualify as a 'new build', in which case interest will remain deductible.

The date of 27 March 2020 is one year earlier than expected. Properties that qualify as social, emergency, transitional or council housing will be excluded from the interest limitation rules, regardless of their new build status.

It is also proposed that if interest is treated as non-deductible, but the property is sold and the sale is taxable under the brightline test, then the previously denied interest deductions are able to be claimed as a cost thereby reducing the taxable profit on sale.

A key question in recent months has been how long interest deductions will last for new builds.

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As per the draft legislation, interest on new builds will remain deductible for 20 years from the issue date of the CCC. Furthermore, interest will remain deductible for subsequent owners throughout the 20-year period, abandoning the potential requirement of being an 'early owner' outlined in the June discussion document.

A previous amendment extended the bright line period to 10 years for residential property acquired on or after 27 March 2021. However, new builds purchased on or after 27 March 2021 (one year later than the relevant date above for interest deductibility) remain subject to a 5-year bright line period.

Unlike the interest exemption for new builds, the new build bright line period of 5 years does not apply to owners that purchase the new build more than 12 months after the CCC has been issued. Therefore, in general, subsequent owners will not get the benefit of the shorter 5 year period.

In a welcome and unexpected development, limited rollover relief for certain transfers to trusts, LTC's, partnerships and individuals will be introduced. This will allow property transfers to take place without triggering the bright-line test where there is no economic change of ownership.

The above is a summary of the key features of the legislation. However, the legislation itself is a lot more complicated due to the large number of varied situations and permutations that must be catered for in practice.

Despite the answers the draft legislation has brought us, it is apparent that navigating the rules (both new and old) will prove complicated and fraught with risk.

Challenges and opportunities in a turbulent job market

In the middle of a pandemic, it can seem at times that the grass is greener elsewhere. Almost two years into a global health crisis that many could not have imagined in their lifetimes, the concept of lockdowns, working from home, a fading connection to the workplace, and the overwhelming feeling of burn-out is driving a surge in resignations in many countries.

With a record number of employees resigning during 2021 in the United States, recent media coverage suggests New Zealand may be heading down a similar path with an uplift in job vacancies being reported.

Several factors are at play in this turbulent job market.

Firstly, as the economy grows out of the pandemic and labour shortages impact many industries, employees are now in the drivers' seat when negotiating their working conditions. Memories of how some employers treated their employees at the height of the pandemic are still fresh. These experiences have reinforced to individuals the importance of family and financial security.

Hence, with the roles now reversed, employees are driving negotiations for better pay and perks to achieve financial security, while also seeking a better work life balance to prioritise family. Workplaces that fail to identify the changing landscape of employee needs risk facing high employee turnover.

Secondly, while thousands of Kiwis rushed home as the pandemic surged in 2020, with border re-openings now in sight, a wave of young professionals ready to embark on the infamous Kiwi OE is expected to leave behind a list of vacancies.

The accounting profession does not need to look far. Pre-covid, the 'Big four' accounting firms were accustomed to the trend of newly qualified Chartered Accountants (CA) leaving for the bright lights of Europe and the United Kingdom. With the pandemic impacting these plans, hundreds of recently qualified CAs are likely planning a European summer in 2022.

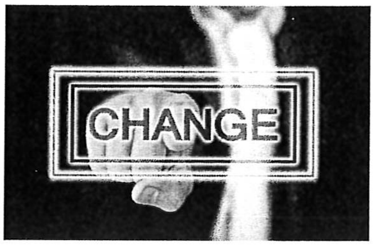
Resignations and higher turnover have a direct impact on business productivity. Having survived a pandemic, businesses now need to adapt to retain employees to thrive. Retaining staff is about offering opportunities of growth, training, and flexibility between work and personal life.

If employees can see a business adapting to their needs and recognising their contribution, they might realise that greener pastures are still at home.

New tax legislation

On 9 September 2021, the Government introduced the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill ("the Bill") into Parliament, containing over 100 tax amendments. Changes of note are summarised as follows.

One significant amendment is in relation to purchases from associated persons. Under current law, if a GST registered person ('the purchaser') acquires second-hand goods from an associated person who has not used them to make taxable supplies, and that associate originally purchased the goods from a non-GST registered person, the purchaser's second-hand goods deduction is zero. This has been a frustrating and illogical rule that has caught out numerous taxpayers over the years – they will know who they are. In what is an arguably overdue amendment, it is proposed that the purchaser (in the above situation) will be allowed to claim an input tax deduction equal to the tax fraction of the original purchase price of the associated person.



When the top marginal tax rate increased to 39%, there was a flow on increase to the default FBT rate from 49.25% to 63.93%, which has meant employers applying one of the default or short form options are arguably overpaying FBT in the first three quarters. Under the proposed new pooled alternate option, employers would only pay FBT at the increased rate for employees with all-inclusive pay of $129,681 or more, which generally equates to employees that are subject to the top marginal income tax rate (i.e. for employees that earn over $180,000). On the other hand, FBT would be payable at the 49.25% rate in relation to employees with all-inclusive pay of under $129,681 (i.e. employees that earn less than $180,000). Consequently, this should prevent employers from overpaying FBT during the year.

Reflecting how complex the residential bright-line provisions are becoming, the Bill also contains further refinements to these rules. For example, one amendment proposes that where a main home takes longer than 12 months to construct, the construction period will continue to be treated as "main home days" for bright-line purposes.

The average person may not realise that sales suppression software exists. However, this is a key point of contention for Inland Revenue, as this software alters point-of-sale data to manipulate revenue – facilitating tax evasion. While not necessarily commonly used, Inland Revenue considers the spread of such software to be a major risk to the integrity of the tax system. Thus, criminal and civil penalties of up to $250,000 are being introduced for the supply or possession of such software.

Finally, in what seems to be the end of an era for 'baby boomers' and late adopters of technology, fax as an approved method of communication with Inland Revenue is being removed.

Where is this going?

On 2nd December 2020, legislation was introduced by the Government that increased the top personal marginal tax rate to 39% on income over $180,000 from the start of the 2021/22 income year.

Three other changes were included in that legislation. It introduced:

- new information gathering powers for the purpose of tax policy development,
- a new requirement for most trusts that derive assessable income to prepare financial statements, and
- increases the information that trusts must disclose as part of the income tax return filing process.

This legislation was enacted under urgency and did not go through the usual consultation process. At the time, David Parker signalled that if trusts are being used for the sole purpose of paying a lower tax rate "we will move on it".

Fast forward one year and three things have happened.

Firstly, Inland Revenue has initiated a research project in which it is examining the lives of 400 New Zealand taxpayers worth in excess of $20m to estimate their effective tax rate on economic income (which is broader than taxable income).

A range of information will be demanded for the 2016-2021 income years including details of partners and dependants, significant personal assets (how much they cost and the date acquired), real estate interests, details of companies and trusts, and other financial flows.

This information is being demanded under the new legislation referred to above, with requests separated into three tranches due in November 2021, January 2022 and May 2022, each delving further into the lives of these taxpayers to enable Inland Revenue to measure the 'households' total income. The results of Inland Revenue's research project will be released in an anonymised form in mid 2023.

Secondly, on 15th October 2021 Inland Revenue released an Officials Issues Paper seeking feedback on what level of detail should be required within a trust's financial statements pursuant to a future Order in Council. A draft operational statement was also released by Inland Revenue on the same day which proposes how the new information gathering powers will apply to trusts. Based on the draft statement the following types of information will need to be submitted each year:

- a statement of profit or loss and a statement of financial position,
- details of taxable and non-taxable distributions and who they have been paid to, and
- the nature and value of any settlements onto a trust, and who a settlement has been made by.

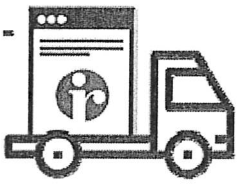
The third element to factor into this picture is that the increase in information to be provided is occurring at a time when Inland Revenue has implemented a new IT system that provides them with an unprecedented ability to analyse and manipulate data.

During the build up to the general election in 2020 Jacinda Ardern ruled out Labour bringing in a capital gains tax under her leadership. However, as the new information that is being gathered is analysed, it might reveal a segment of income being used for the necessities and luxuries of life that have not been taxed; which could open the door for a generational change to the basis on which income tax is levied.

Snippets

GST warranty

Near the top of the first page of the Auckland District Law Society "Agreement for Sale and Purchase of Real Estate" sits the following question:



The vendor is registered under the GST Act in respect of the transaction evidenced by this Agreement and/or will be registered at settlement: Yes / No.

The answer to the question comprises a warranty by the vendor regarding their GST registration status.

A recent Court of Appeal decision, Marr v Mills, reinforced the need for the question to be answered correctly. The vendor, Ms Marr, declared herself to be not registered for GST. Relying on this GST declaration, the Mills commenced plans to start a business from part of the property with the expectation that a GST second-hand goods deduction would help fund the set-up of the business.

After undertaking extensive planning, seeking accounting advice and getting a valuer to determine an apportionment of the property value, the purchasers became aware that Ms Marr was GST registered. Unable to claim any GST, the Mills opted not to commence business.

Subsequently, proceedings were issued against Ms Marr for a breach of warranty, with the District Court identifying a clear loss and awarding damages amounting to the expected GST refund plus interest and other costs incurred. Ms Marr appealed to the High Court, which was dismissed, and more recently the Court of Appeal declined an application for leave to appeal, upholding the lower Courts decision.

Care needs to be taken when completing a land sale. With the surge in property valuations and property development activity, an incorrect GST declaration could prove to be a costly mistake.

Covid rewards

As the world moves to a vaccine-based approach to manage Covid-19 there have been some interesting incentives to boost vaccination rates.

Across New Zealand, organisations including KFC, New Zealand Rugby and local burger and kebab joints have got on board by giving away freebies to vaccinated individuals. However, Amazon's incentives top these freebies after they gave away 18 prizes including cars and $100,000 pay-outs in an employee sweepstake worth nearly $2m.

Overseas, some countries are going all out in a bid to get their population vaccinated. Across the ditch, fully vaccinated Australians have the chance to win one of eight prize packs from Qantas, consisting of a year's worth of free flights, hotel stays and fuel, valued at $85,450 each. In the USA, Minnesota has given vaccinated teenagers the opportunity to win a $100,000 college scholarship, New York City offers either $100 or a free attraction ticket and Washington is offering teenagers AirPods to boost vaccination rates.

Incentives for vaccinated individuals differ from country to country from a local Japanese Government offering a car as a prize and a Hong Kong property developer raffling off an apartment worth $1.4m, to Romanians receiving a barbequed sausage and a Philippine town raffling off a cow.

Everyone does love a freebie, and as a country, we will try anything to get across the line of freedom and enjoy a Kiwi summer this year.

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