Tax Tips Alert | March 2022

Tax Bill to be passed by Parliament

- Interest limitation
- Bright-line
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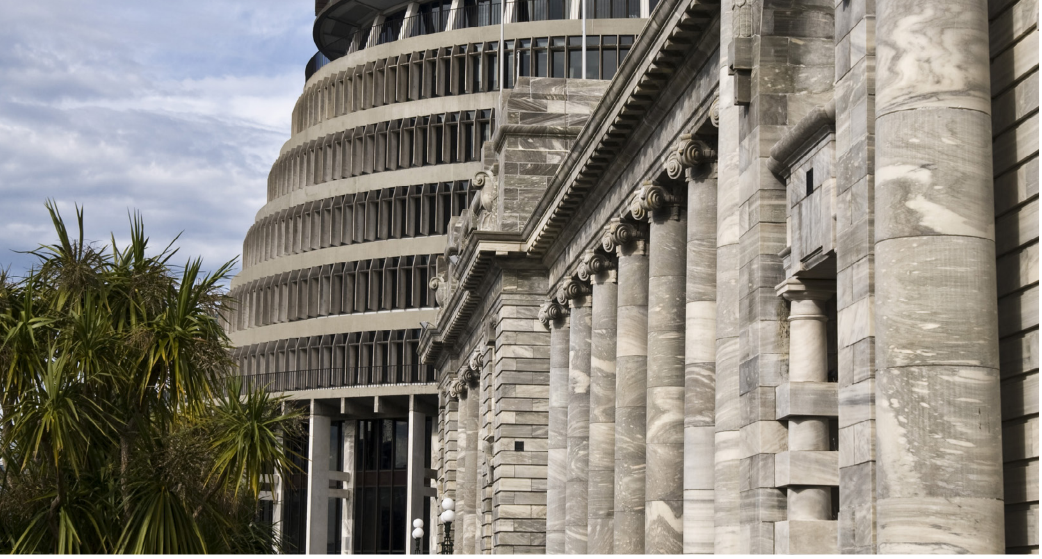


Omnibus tax bill reported back

The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill (the Bill) is expected to be passed by Parliament shortly. A number of changes were made to the Bill as a result of recommendations by the Finance and Expenditure Select Committee (the Committee) following from the submission process.

The Bill contains a variety of policy and technical changes. Our September and October 2021 Tax Tips covered some of the key proposals; this issue focuses on changes made in key areas by the Committee, including the interest limitation rules, the bright-line test, goods and services tax (GST) and local authorities.

It is interesting to consider the political backdrop to this Bill – in particular, the Opposition leader's recent promise to repeal every tax increase introduced by the current Government since it took office, if National wins the next election. On 6 March, Christopher Luxon delivered the message in his "State of the Nation" speech in Auckland, promising repeal of the regional fuel tax, the light rail tax, the bright-line test extension and interest limitation rules for property investors. The longevity of some of the changes in the Bill may depend on the outcome of the next general election.

Interest limitation

The Government unveiled the details of its controversial tax response to housing affordability in a Supplementary Order Paper (SOP) to the Bill last year. Essentially, it proposed that interest deductions in relation to residential investment properties will be disallowed (with deductions for interest on existing loans to be phased out over time).

There are some helpful statements in the Committee's report – for example, a clear statement of policy intent is given: "limiting interest deductibility is to make residential property a less attractive investment option", and in terms of coverage "that the interest limitation rules should apply to property that is, or could foreseeably be, used for long-term residential accommodation".

The Committee recommended several amendments to the Bill as first introduced, which we have summarised below.

Exemptions for social, emergency, transitional, and council housing

The Committee agreed with submitters that the current definition of social housing should apply to some social housing leased by government agencies, as well as housing provided via a council-controlled organisation. For example, the Ministry of Health operates some addiction and rehabilitation services, which would otherwise be disadvantaged by these provisions. Accordingly, the Committee recommended

clarifying that housing leased by government departments for non-transitional or non-emergency accommodation for the public should qualify for the exemption. In addition, the council housing exemption is extended to leased properties that are used to provide council housing.

The Committee recommended that the Bill be amended so that the social and council housing exemption applies where housing is the “sole purpose”, ensuring that wrap-around services or support for residents does not disqualify the organisation.

Excepted residential land

The Committee did not recommend significant changes to the definition of “excepted residential land” (to which the limitation rules would not apply). As such, there is no blanket exemption for boarding houses, serviced apartments or short-stay accommodation.

However, several helpful changes are proposed:

- Large commercial-scale boarding establishments will be expressly exempt.
- Trustees may only qualify for the exception for a beneficiary or settlor of a trust if a principal settlor of the trust does not have a separate main home. This would prevent people from restructuring assets into trusts and avoiding interest limitation by claiming the property is the beneficiary’s main home.
- Housing provided to a shareholder or beneficiary of a Māori entity, on land owned by one of that entity’s wholly-owned subsidiaries, is exempt.

The Committee rejected several submissions that ground leases should be excluded from the interest limitation rules, given the legal estate of a ground leaseholder does not include any improvements on the land and is not equivalent to that of a freehold owner.

Exemptions for new builds and property development

The Committee rejected several submissions asking for an expansion of the “new build” definition – for example, to include renovations and repairs generally. That said, two new specific inclusions were recommended:

- where the dwelling has been on the earthquake-prone buildings register, but remediated and removed from the register on or after 27 March 2020, and
- where a leaky home has been substantially (at least 75%) re-clad.

The development exemption has also been updated. Now, if a taxpayer sells a property at a loss after developing it, the development exemption can continue to apply.

The Committee did not agree that build-to-rent (BTR) developments should be entitled to an exemption. However, the report indicates that the Government is considering special rules for BTR developments, and further information will become available this year.

Bright-line

Main home exclusion widened for new builds facing delays

There has been a slight change to the "main home" exemption to the residential bright-line test.

Under current law, for properties purchased from 27 March 2021 onwards, a "change of use" rule has been in effect, which means the exemption only applies for the period the land is used as a main home. However, the exemption will now apply even if the property is not the owner's main home for up to 12 months, so long as this 12-month period precedes or follows a period of main home use (with periods of greater than 12 months not being eligible for the exemption).

In the case where the person is constructing a dwelling (where it is feasible that construction delays could lead to a main home being built within 12 months) the 12-month limit to the "change of use" rule can be extended to cover the period of construction, provided that construction time period is "reasonable". Whilst not specifically limited to new builds, realistically this extension will be most relevant to the 5 year residential bright-line test for new builds.

This is a taxpayer-friendly change that ensures construction delays do not result in homeowners being taxed on gains attributable to the construction period.

"New build" definition widened

Two changes have been made to widen the "new build" definition for the 5 year residential bright-line test:

- Where a person owns new build land, and then builds another dwelling on their property, that "new" new build would qualify for the 5-year new build bright-line test. This is subject to the other requirements of the new build bright-line test being met.
- Given the "new build" definition is in part assessed during the disposal of the property, an amendment has been made to clarify that "new build" also encompasses properties that would have qualified but have since been destroyed because of a natural disaster or fire (so either no property exists or a second dwelling has since been built).

Widening of roll-over relief provisions

The proposed roll-over relief provisions for the residential bright-line test have been expanded in their application. Previously, the Bill was drafted such that the roll-over relief would only apply from a person to a look-through company, partnership, trust or Māori authority that met certain criteria that ensured the economic ownership of the property remained unchanged (e.g. from a person to a family trust of which they are settlor).

It is proposed that this roll-over relief extends not only for transfers from a person to the entity (e.g. property transferring from a settlor to its trust) but from the entity back to its economic owner (e.g. property transferring from a trust back to its settlor). Residential property transferred between members of wholly-owned tax consolidated groups is also proposed to be subject to roll-over relief.

The Officials' report back to the Committee also recommended further broadening the roll-over relief provisions to allow for transfers between persons which do not result in a change to the ultimate economic ownership of the property. However, it is unclear from the current drafting that such transfers have been captured. In our view, further remedial changes will be required if the Bill is enacted in its current state.

New Zealand leading the way with tax changes concerning cryptoassets

GST

The GST changes concerning cryptoassets are both significant and comprehensive. They will help reduce the uncertainty that has existed in this area for some time and will reduce market distortions. The Bill confirms the following key GST changes:

- cryptocurrency will be excluded as a taxable or exempt supply – this wide ranging change is innovative and will allow cryptocurrency transactions to be ignored for GST
- non-fungible tokens (NFTs) will be covered by the standard GST rules and the remote services rules (if the consumer is a NZ resident in the case of remote services)
- brokerage and commission services in relation to cryptocurrency will be exempt from GST
- options over cryptocurrency will be exempt from GST.

All of the above changes will be retrospective to 1 January 2009 (when Bitcoin was launched). In addition, GST costs incurred as part of a cryptocurrency issue will be recoverable by a GST-registered business (retrospective to 1 April 2017).

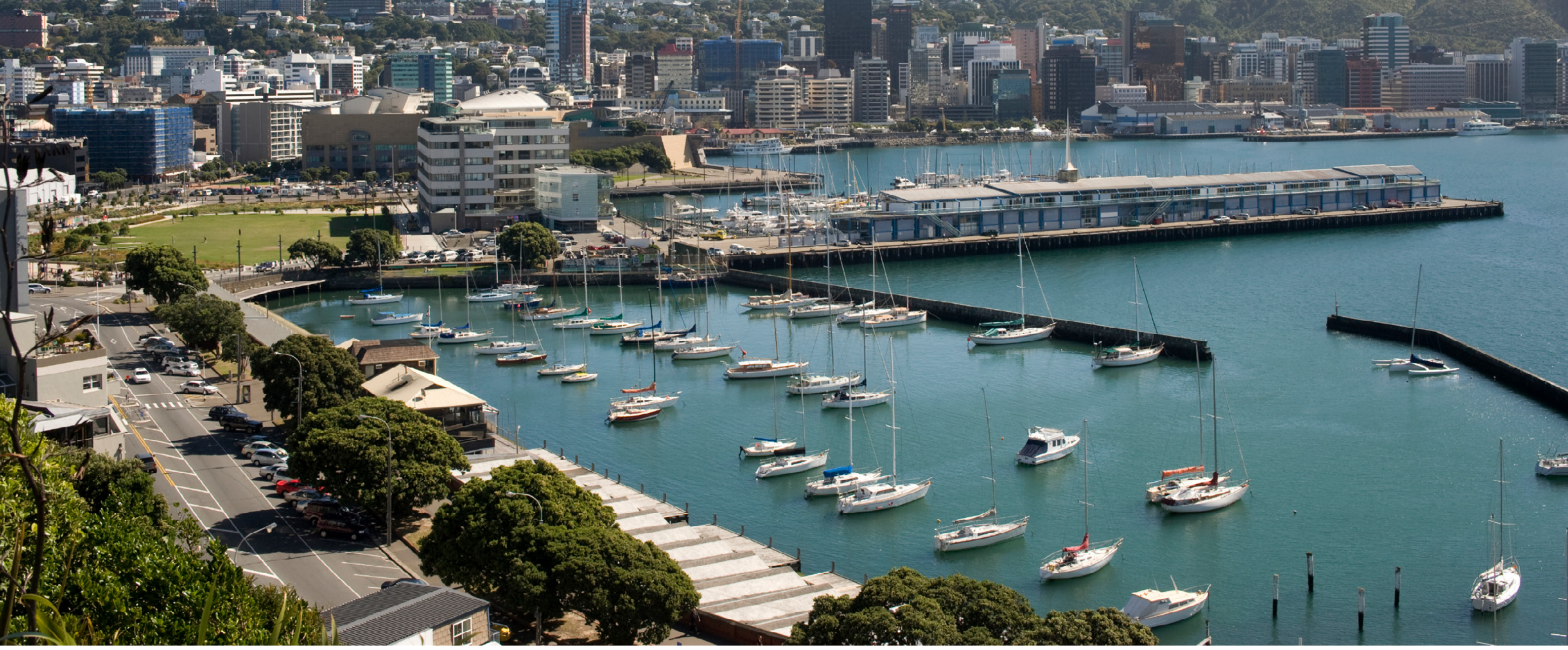
Income tax

Under the Income Tax Act 2007, certain financial arrangements are excepted from the financial arrangement rules. The Bill confirms that cryptocurrency is an excepted financial arrangement, as well as an option to acquire or dispose of cryptocurrency. In order to align the treatment for derivatives over shares – that are subject to the financial arrangement rules – any derivatives over cryptocurrency will be treated in the same way.

These changes are effective from 1 January 2009 and are designed to remove market distortions.

What's changed since the Bill was introduced?

- GST definition of "cryptoasset" amended to remove the general fungibility requirement
- "Non-fungible tokens" specifically defined and excluded from the definition of "cryptocurrency" for GST purposes
- Brokerage in respect of cryptocurrency GST exempt
- Options over cryptocurrency GST exempt
- Futures to be subject to the financial arrangements rules, but options to be treated as excepted financial arrangements



Changes to the GST invoicing requirements

The Bill includes a raft of changes intended to modernise the GST invoicing and record-keeping requirements to ensure they are fit for modern business practices. The main change is removing the requirement to issue and hold a single prescribed "tax invoice" document. Rather, the GST requirements would be met if specified GST information is provided and held, regardless of the source(s) (e.g. commercial invoices, supply agreements, or other business records).

Although many submitters supported the idea, the drafting is complex and difficult to navigate. Many raised concerns that the proposals gave rise to additional or different requirements than under current law, which would have systems and legal impacts on businesses. Although the current tax invoice requirements are relatively rigid and inflexible, they are well understood and businesses have built systems and entered into contracts based on the current requirements and terminology.

A key change in the legislation is that the application date for the changes relating to the content of tax invoices/taxable supply information has been deferred by one year and will apply for taxable periods beginning on or after **1 April 2023**. This will provide taxpayers sufficient lead time to understand and implement the changes before they take effect.

However, the following changes will take effect from the date of Royal assent to provide more flexibility for businesses:

- No need to obtain the Commissioner's approval to issue Buyer Created Tax Invoices. However, the supplier and the recipient must still agree certain matters and record that agreement in writing.
- Reissued invoices will no longer have to be marked "copy only".
- Changes related to shared tax invoices.

What's changed since the Bill was introduced?

- A number of drafting changes intended to address inconsistencies and improve legislative clarity. However, the drafting is still cumbersome, and further issues may need to be addressed as remedial changes.
- References to the old terms "tax invoice", "credit note" and "debit note" are preserved for existing contracts.
- Simplified requirements for lower value transactions (i.e. less than $1,000).

- Removal of the proposed new requirement to provide taxable supply information on the day of the supply. For supplies made to non-GST registered persons, suppliers have 28 days from when the customer requests the information. For supplies made to GST registered persons, suppliers have 28 days from the day of the supply to provide the information. Under current law, there is only one rule – i.e. a tax invoice is only required to be issued to a GST registered person within 28 days of a request.
- Removal of the requirement to record the "time of supply or anticipated time of supply".
- Removing the requirement to keep a record of all issued copies of invoices.
- Under the rules for GST registered persons issuing shared invoices (other than GST groups, which have separate rules) the joint and several liability requirement has been removed. GST groups remain joint and severally liable for GST group members' GST obligations.

The deferral of the application date is positive as businesses will need to work through the impact of the new rules. However, in our view, this reflects the fact that the new rules are not as user friendly as they could have been due to the way they have been drafted and designed.

E-invoicing

The new GST documentation and record-keeping requirements are intended to future-proof the GST rules to be compatible with e-invoicing. There are no requirements to use e-invoicing yet in New Zealand. However, the Government has committed to ensuring that all central Government agencies are capable of receiving e-invoices by 31 March 2022.

Other GST proposals – key changes to the proposals as introduced

The Bill contains a number of other GST changes, which were previously summarised in our September 2021 Tax Tips. A number of further changes were made to these proposals following public submissions to the Committee. In summary:

- **GST grouping**: The ability for companies leaving GST groups to limit their joint and several liability will be made retrospectively available for transactions entered into after 8 September 2021 (the date of the introduction of the Bill) and completed by Royal assent.
- **Secondhand goods deductions for transfers between associates**: a transitional rule has been included to ensure that the new rule applies for transfers under an agreement made after the Bill was introduced and for which payment was made on or after the start of the first GST period after the Bill receives Royal assent.
- Various technical drafting changes.

Changes to Local Authority income tax rules

The Bill introduced a number of changes with the aim of disallowing local authorities from transferring their tax exempt status benefits to taxable Council Controlled Organisations (CCO). In an attempt at addressing the integrity of the tax system, some immediate reform for local authorities has taken priority over taking a broader and more holistic view.

The following modifications to the income tax rules currently applicable to local authorities have been introduced through the Bill.

Dividends

As initially proposed, dividends paid from wholly owned CCOs, port companies or energy companies to local authorities would be deemed exempt from tax. The Bill now extends the exemption to include both wholly and partly owned CCOs, port companies and energy companies.

In addition, dividends from CCOs received by CCO holding companies with 100% local authority ownership will also be exempt income. (These changes have effect for the 2022-23 year and beyond.)

Donations

The Bill removes the ability for local authorities to claim a deduction for charitable donations, with effect from the 2022-23 income year onwards. However, the Committee's report has clarified that CCOs within a consolidated group will still be allowed to claim deductions for charitable donations.

Imputation credits

The proposed restriction from converting imputation credits to tax losses has been removed. This is on the basis that it's no longer necessary given the changes to exempt dividends.

Whilst imputation credits will not be required to be attached to the exempt dividends paid to local authorities, CCOs may choose to do so.

Interest deductions

The Bill originally proposed that deductions for finance costs would be limited to only those incurred on loans to Council Controlled Trading Organisations (CCTO) and borrowings to acquire shares in a CCTO. This was concerning as it would have the effect of disallowing interest deductions relating to CCOs, despite there being a nexus to assessable income. Further, the definitions of CCO and CCTO between the Income Tax Act 2007 and the Local Government Act 2002 were not entirely clear.

As a result of the concerns raised, this proposal is being deferred pending further work on the definitions of CCO and CCTO and the wider local government sector reforms. This is extremely positive, as this proposal had the potential to significantly raise the cost of borrowing for local authorities, the implication being an increase in rates for ratepayers.

Tax loss offsets

The Committee's report has confirmed that tax loss offsets will remain possible within local authority groups that meet the normal criteria, and that a local authority's historic tax losses will still be able to be carried forward.

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