COVID-19 economic support package: Legislation enacted

➨ Tax Tips Alert March 2020

As the country headed towards a lock-down under Level 4 of the COVID-19 alert level system this week, Parliament passed legislation under urgency on 25 March 2020 to give effect to the Government's COVID-19 economic support package.

We have previously summarised the Government's announcements. However, due to the rapidly evolving nature of the situation, it has been difficult for many individuals and businesses affected by COVID-19 to find out detailed information relating to how the announcements apply to their particular circumstances. We have summarised below the key features of the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 (**the Act**) and the COVID-19 Response (Urgent Management Measures) Legislation Act 2020 (**the Urgent Measures Act**) that individuals and businesses should be aware of when considering how the changes apply to their circumstances.

Tax changes

Restoring building depreciation

As previously announced, depreciation deductions will be reinstated in relation to non-residential (i.e. commercial and industrial) buildings, reversing the removal of depreciation deductions for all buildings which came into effect from the 2011-12 income year. The changes will come into effect from the start of the 2020-21 income year and will apply to:

- buildings owned at the beginning of the 2011-12 income year
- newly acquired buildings, and
- capital improvements made to existing buildings.

Eligibility – "non-residential buildings"

Depreciation will not be permitted in relation to "residential" buildings, which is defined as:

- a "dwelling" as that term is currently defined in the Income Tax Act 2007, and
- a building in which accommodation is ordinarily provided for periods of less than 28 days at a time if the building, together with other buildings on the same land, has less than four units intended for separate occupation.

This means that, generally speaking, buildings people live in (i.e. owner-occupied houses and apartments or properties subject to residential tenancies) will not be depreciable. The second limb of the definition is intended to also deny depreciation deductions for buildings used to provide "short-stay accommodation" such as baches and AirBnBs.

However, there is a carve-out for such buildings used to provide short-stay accommodation if they have more than four units. This is intended to allow commercial operations such as motels or hotels to claim depreciation on their buildings.

Valuation for tax depreciation purposes

The depreciation deductions will be based on the opening tax book value of the building as at the beginning of the 2020-21 income year.

For buildings that were already owned by the taxpayer at the end of the 2010-11 income year, the tax book value would be based on:

- The adjusted tax book value at the end of that year, less any deductions for fit-out that the taxpayer has already claimed, **plus**
- Any non-deductible capital expenditure on the building incurred from the start of the 2011-12 to the end of the 2019-20 income year.

For buildings acquired since depreciation deductions for buildings were removed, the value would be based on:

- The cost of the building, **plus**
- Any non-deductible capital expenditure on the building from the time acquired to the start of the 2020-21 income year.

Rate of depreciation

The depreciation rate will be either on a 2% declining value (DV) basis or at a 1.5% straight line (SL) basis. Alternatively, taxpayers may apply to the Commissioner to receive a special depreciation rate.

Depreciation on a DV basis allows a deduction to be claimed equal to 2% of the adjusted tax book value of the building at the end of each income year. Whereas depreciation on a SL basis allows a deduction to be claimed at 1.5% of the opening tax book value of the building for the 2020-21 income year (i.e. the amount of depreciation loss for each full year of use remains the same each year).

Depreciation recovery income

If the building is sold, the taxpayer may be required to return as depreciation recovery income if the consideration received for the building exceeds the adjusted tax value. This will take into account any deductions taken prior to 2011-12 as well as deductions taken from 2020-21.

PwC comment

The Minister of Finance explained that the reintroduction of depreciation for non-residential buildings is intended to provide help with cash flow for businesses during the COVID-19 pandemic. It is also intended to support economic recovery following the COVID-19 outbreak by removing a tax distortion that discourages investment in commercial buildings.

We support the changes, which will provide a cash benefit to businesses during these challenging times. It is an area of New Zealand tax policy which the Tax Working Group recently recommended be reformed, as New Zealand was an outlier internationally in disallowing any form of depreciation on buildings.

How does restoring tax depreciation impact deferred tax?

Impact on balance dates before 25 March 2020

For accounting periods (including interims) ending before 25 March 2020, but where financial statements are yet to be authorised for issue, the nature of the legislative change and an estimate of its financial effect (if sufficient details are available) should be disclosed as a non-adjusting post balance date event where this is material.

Impact on balance dates after 25 March 2020

For accounting periods ending after 25 March 2020, the reinstatement of tax depreciation on buildings will impact deferred tax depending on whether the carrying value of buildings are expected to be recovered through use or sale under NZ IAS 12.

For entities where their buildings are recovered through sale, there should be no change to the calculation of deferred tax.

For entities where their buildings are recovered through use, the deferred tax impact will depend on whether it was an existing building held at the time when the tax depreciation was changed to 0% or was acquired afterwards.

- **Buildings acquired pre May 2010**
  In 2010, the tax depreciation on buildings with an estimated useful life of 50 years or more was reduced to 0%. This change reduced the tax base of those buildings where deferred tax was measured on a use basis as future tax depreciation deductions were no longer available from the 2011/12 tax year resulting in an increase in the deferred tax liability for those buildings.
  The reinstatement of tax depreciation on these buildings will increase the tax base by effectively reversing the original deferred tax liability. To the extent the new tax base exceeds the carrying value, a deferred tax asset may arise.

- **Buildings acquired or building capital expenditure post May 2010**
  The deferred tax impact is more complex where buildings were acquired post May 2010 and the initial recognition exception has been applied. If the initial recognition exception was applied no deferred tax would have been recognised (other than in relation to subsequent revaluations).
  There is a degree of uncertainty on the application of IAS 12 for the tax change where the initial recognition exception has been applied previously. One view is to continue not recognising deferred tax (other than on revaluations) when the change occurs unless the tax base exceeds the carrying value of the property, in which case a deferred tax asset will arise, subject to recoverability. We note that the thinking may continue to evolve in this area in the coming months.

There may also be many different scenarios that entities may have to think through.

The reinstatement of tax depreciation on commercial buildings could have a significant positive effect on the financial position of many entities. Companies should take steps to quantify the impact of the changes on their deferred tax assets and liabilities and reported results.

The impact of the change on banking covenants, thin capitalisation position, continuous disclosure requirements, and broader stakeholder communications should also be considered.

Changes to provisional tax thresholds

Businesses are required to pay income tax provisionally (i.e. in installments) throughout the year if their residual income tax exceeds $2,500. Residual income tax can broadly be understood to be a taxpayer's income tax liability after tax credits have been applied.

Provisional tax is intended to ensure that the Government receives some income tax from taxpayers in instalments throughout the year, instead of waiting for a lump sum at the end of the tax year (taxpayers not subject to provisional tax usually just have to pay the tax amount by 7 February following the end of their income year).

However, having to pay provisional tax throughout the year means that businesses will not be able to use that cash during the year. To help support cashflow for businesses during the COVID-19 outbreak, the threshold for having to pay provisional tax is being raised from $2,500 to $5,000 of residual income tax.

We support these measures, which will mean that 95,000 taxpayers who would otherwise have been required to pay provisional tax will have that cash to stay afloat until normal business operations resume. The change to the provisional tax threshold will be permanent. We note that this measure was also recommended by the Tax Working Group as part of its 2019 review of the tax system.

Low-value asset threshold

Taxpayers are currently allowed to deduct the full value of assets worth less than $500 (instead of being required to depreciate them over the economic life of the asset). The Act will increase this threshold to:

- $5,000 for assets purchased in the 12 months from 17 March 2020
- $1,000 for assets purchased from 17 March 2021.

The initial, temporary increase to $5,000 is intended to encourage taxpayers to bring forward any planned investments and encourage spending in the immediate term. The low-value asset write-off threshold will then be $1,000 going forward.

Use of money interest (UOMI) remission

UOMI is charged by Inland Revenue in relation to late or underpaid amounts of tax. It is not a penalty per se but intended to compensate Inland Revenue for the loss of the ability to use the money. The current rate of UOMI which applies to underpaid tax is 8.35%. While Inland Revenue has some discretion to remit penalties levied on late payments or shortfalls of tax, it usually has very little discretion to remit UOMI.

The Act will allow Inland Revenue greater discretion to remit UOMI in the following circumstances:

- the taxpayer's ability to pay tax was significantly affected by the COVID-19 outbreak, and
- the tax payment was due on or after 14 February 2020.

Circumstances where Inland Revenue will agree to a remission would include, for example:

- the taxpayer was quarantined and physically unable to make the payment, or
- the taxpayer does not have the financial means to pay due to the economic impact of COVID-19.

Inland Revenue will be releasing further guidance on the kinds of circumstances that would qualify for remission.

In order to receive a remission, taxpayers should ask Inland Revenue as soon as practicable and pay the core tax amount as soon as they can. The interest will only be remitted if the core tax is eventually paid.

This measure will apply for a 24-month period from 25 March 2020 (when the Act was enacted), but it can be extended by Order in Council.

PwC comment

We consider this to be a necessary measure to ensure that taxpayers are not placed under unnecessary additional financial hardship due to UOMI being applied in circumstances outside of the taxpayer's control. In our view, the eligibility requirements should be applied widely to ensure that all circumstances arising as a direct result of COVID-19 are covered. The economic recovery from the effects of COVID-19 would not be aided by an unduly strict enforcement of the UOMI rules given the extraordinary circumstances.

Research and development (R&D) tax credit refundability

The tax changes summarised above were all previously announced by the Government on 17 March. One new tax change included in the Act relates to the refundability of R&D tax credits.

Last year, the Government introduced a new R&D tax incentive scheme (applying from the 2019-20 income year) which provides for a 15% tax credit in relation to eligible R&D expenditure. However, the proposals as currently enacted did not generally provide for refundability of the R&D tax credit if, for example, the taxpayer is in a tax loss position and therefore unable to use the credit in that tax year. (Some limited refundability rules were put in place for a small portion of eligible R&D tax credit claimants). It was proposed at the time that broader refundability of the R&D tax credit would apply from the 2020-21 income year. However, as part of the Government's economic support package in response to COVID-19, this application has been brought forward by one year, to the 2019-20 income year.

PwC comment

This change will give eligible businesses access to an immediate cash injection to help navigate the economic impact of the COVID-19 outbreak and the ensuing fallout. It will also encourage businesses to continue or start new R&D, which will be a helpful stimulus during the economic recovery from the fallout of the COVID-19 outbreak.

GST on COVID-19 related payments

An Order in Council was passed on 24 March 2020 to ensure that the COVID-19 wage subsidy and leave payments made by the Ministry of Social Development (MSD) are not subject to GST. However, the Order only applies prospectively and payments have been made since 17 March 2020. The Act ensures that payments made between 17-24 March 2020 are also not subject to GST.

Support for individuals

Social benefit payments

In addition to the tax changes for businesses, the Government will be extending eligibility for a number of existing entitlements:

- The **In-work Tax Credit (ITC)** is an income-tested cash payment for working families with children. However, to be eligible, families must have worked a certain number of hours in a week. The Act **removes the hours-worked requirement** so that families with reduced working hours as a result of the COVID-19 outbreak do not lose their eligibility.
- **Working for Families (WFF)** tax credits were not available to families receiving emergency benefits on a temporary visa. The Act will **remove the residence requirement** so that people on temporary visas can qualify for WFF if they receive an emergency benefit from MSD.
- The amount of the **winter energy payment (WEP) has been doubled.** The increased WEP will be paid automatically for those already eligible. This increase is temporary and the current WEP rates will apply again from 2021.

Tenancy protection

The Urgent Measures Act also includes temporary changes to the Residential Tenancies Act 1986 to enact rent freezes and restrict termination of tenancies for residential tenants. The measures will apply for three months from the date of enactment (25 March 2020) but may be extended by another three months by Order in Council.

- Tenancies cannot be terminated during this period except in certain very specific circumstances. This includes, for example, if the tenant and landlord agree to end the tenancy or if the tenant engages in anti-social behaviours such as harassment or causing harm or disruption.
- A tenancy can be ended by the landlord by application to the Tenancy Tribunal if the tenant is more than 60 days behind in rent (which extends the usual 21 days before a tenancy can be terminated). However, the Tribunal can refuse the application if the tenant made best endeavours to pay and it would be unfair in the circumstances.
- Fixed term tenancies due to expire during this period will continue as periodic tenancies.
- If the landlord and tenant had agreed before 25 March 2020 that the tenancy would end during this period, the tenant can give notice to the landlord to continue the tenancy.
- Rents cannot be increased for a six-month period from 25 March 2020.

For further guidance on how these measures can help you and your business through this difficult time, please reach out to your usual PwC adviser.

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