Tax Tips August 2019

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The Government's tax policy work programme

The Government has recently announced its new *Tax Policy Work Programme (TPWP)*. The TPWP outlines the Government's priorities for tax refom. It is generally updated every 18 months.

Unsurprisingly, a number of the items in this latest edition of the TPWP stem from the recommendations contained in the Tax Working Group's (TWG) final report to the Government. The main focus areas include reducing compliance costs for small and medium enterprises, infrastructure, and the environment – all of which are consistent with the TWG's final report. It is also great to see a specific reference to remedial amendments as we agree it is important that tax legislation is regularly maintained and updated to ensure it operates as intended.

We discuss some of the key items below.

Business

Reducing compliance costs is a key focus, especially for small businesses and the self-employed.

The Government has committed to improving the neutrality of New Zealand's tax system through changes to current tax settings that are resulting in economic distortions. Possible changes arising from the TWG recommendations include:

- considering the tax treatment of the costs of seismic strengthening
- changes to the loss continuity rules to support start-ups
- recognition of deductions for "black-hole" expenditure (which is not immediately deductible or depreciable over time) such as feasibility expenditure
- simplification of fringe benefit tax (FBT), and
- changes to the rules for tax disputes for smaller taxpayers.

Work will also continue on policy initiatives which are already underway such as:

- research and development tax incentives
- purchase price allocation
- cross-border employment and other employment issues to reflect the changing nature of work
- financial arrangement issues, and
- the sharing economy.

International

A major focus of the Government's corporate tax agenda is on multinationals, especially those in the digital economy. The Government has indicated that it would prefer a multilateral approach to the digital economy through the OECD, but unilateral action is possible in the form of a digital services tax. The international tax project will also include maintaining and updating New Zealand's network of double tax agreements and an ongoing review and monitoring of the recently enacted BEPS rules.

Land

The Government is continuing to review the land taxing rules. Specifically, this review will focus on investment properties, land-banking, vacant land, and speculation.

Particular issues include:

- improving the enforcement of existing land taxing rules, including the use of withholding taxes
- clarifying and narrowing the deductibility of holding costs for revenue account property
- reviewing the exemptions in the land rules, in particular the exceptions for developers and habitual renovators
- reviewing the mixed-use asset GST apportionment rules, and
- information sharing with Land Information New Zealand (LINZ).

In the longer term, the Government may consider:

- tax instruments to discourage land-banking and vacant land
- a review of the "10-year" land rules (which apply to those in the business of land dealing, land development, subdivision, or building)
- rules to improve the supply of land
- allowing losses on disposals of buildings, and
- reviewing the provisional tax rules for bright-line income from land sales.

Infrastructure

As part of the wider Government infrastructure agenda, the Government will look at the role of the tax system in driving infrastructure investment.

The Government's wider policy agenda will seek to make progress towards a sustainable and climate-resilient economy. While few specific considerations are identified in the TPWP, this is expected to involve revenue collection for infrastructure and encouraging nationally-significant projects.

Tax exemptions and charities

The Government will be reviewing the current tax treatment of charities and other income tax-exempt entities such as local and public authorities and Crown-controlled companies.

The review of the charities tax rules will be considered in conjunction with the Government's review of the Charities Act 2005, which will consider charities policy issues that have tax implications. Following the review of the Charities Act, further charities tax policy changes may be proposed.

Specific tax policy issues to be considered include:

- tax rules to address the accumulation of funds and significant business activities of charities
- imputation credit refundability
- tax rules for mutual organisations
- GST obligations for non-profit bodies
- clarifying the approach to social enterprises, and
- reviewing the tax rules for deregistered charities.

Environmental and social policy

Improving environmental outcomes is high on the Government's agenda. Inland Revenue will be providing input into other Government initiatives and will advise on the tax implications of environmental policy. Key areas will include:

- potential reform of the Emissions Trading Scheme (including in relation to agricultural emissions)
- reforms to the Waste Disposal Levy
- supporting the work of the Water Taskforce to improve water quality, and
- a congestion charge for Auckland.

Specific projects will include considering how tax regimes such as FBT could be used to achieve positive environmental outcomes, and reviewing industry-specific tax rules such as the petroleum mining and exploration rules.

The Government also intends to overhaul the social welfare system. This will include changes to Working for Families, child support and the administration of the student loans programme. Changes to KiwiSaver and savings tax policy will include a review of the trans-Tasman portability of superannuation schemes.

Business transformation

The Government will continue to support the implementation of Inland Revenue's Business Transformation programme and leverage its improved technological capabilities. In the next 18 months, there will be system changes to the administration of student loans, KiwiSaver, and child support. In particular, the Government has announced a potential review of the prescribed investor rate (PIR) for KiwiSaver and other PIEs.

GST

The Government has acknowledged the importance of continually updating tax legislation to reflect changes in technology and business practices. An issues paper on various GST policy issues will be released for public consultation to ensure that GST rules align with business practices and modern technology. We expect an officials' issues paper to be released for public consultation towards the end of 2019.

Tax administration

The standard of protection for taxpayer information has recently been changed from "secrecy" to "confidentiality" in the Tax Administration Act 1994. Against this context, the work programme includes a review of Inland Revenue's overall data strategy and the efficient sharing of information between government departments and other jurisdictions.

New tax and social policy engagement framework

Inland Revenue has published its new *tax and social policy engagement framework* (the framework), following feedback from stakeholders. The framework is intended to build on the Generic Tax Policy Process (GTPP), which has been in place since 1994, in guiding tax policy development in New Zealand.

Under the framework, officials have committed to the following principles of public consultation for all policy reforms:

- wider engagement
- engagement with Māori,
- earlier and more frequent engagement,
- the use of greater variety of engagement methods, and
- greater transparency and accountability.

Wider engagement

Inland Revenue intends to consult with a more diverse range of stakeholders when developing policy proposals. Officials will also seek feedback on a wider range of outputs e.g. officials may release exposure drafts of parts of tax legislation before it is introduced into Parliament.

Engagement with Māori

Officials will be adopting the Māori-Crown Relations framework, which has been endorsed by Cabinet to be used across Government agencies. This will involve a sliding scale that stipulates the level and type of engagement required depending on the extent of Māori interests involved.

Earlier and more frequent engagement

Currently, consultation usually occurs after officials have identified potential options for reform. Under the new process, public engagement will begin with opportunities to provide input into identifying the size and nature of the problem.

Variety of engagement methods

Currently, consultation occurs mainly through written submissions on consultation documents and at Parliament's Finance and Expenditure Committee. Inland Revenue will increase its use of alternative engagement tools, such as focus groups, online forums, multi-lingual multimedia content, hui and industry workshops. This is intended to support the principle of wider engagement.

Greater transparency and accountability

Officials have committed to providing feedback to submitters in a timely manner. Key advice papers received by Ministers may also be proactively released to the public.

Exceptions

Despite these changes, Inland Revenue acknowledges that, in some circumstances, full consultation may not be appropriate or possible. Exceptions will be allowed "only on a principled basis". Examples cited were measures from the Budget process, anti-avoidance measures, and urgent Government priorities.

Tax bills update

Bill / Act	Key amendments	Stage	Quick links
Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill	• Will allow Inland Revenue to notify a provider when a multi-rate portfolio investment entity (PIE) investor is on the wrong prescribed investor rate • Proposes refinements to the R&D tax incentive rules to make refundable R&D tax credits more widely available • Remedial amendments to the recently enacted new rules for the taxation of employee share schemes	• Introduced on 27 June 2019 • Received its first reading and referred to the Finance and Expenditure Select Committee (FEC) on 23 July 2019 • Submissions to the FEC close on 4 September 2019 • The Bill is due to be reported back to Parliament on 24 January 2020	*Minister of Revenue press release*
Taxation (Research and Development Tax Credits) Act 2019	Introduced a research and development tax credit of 15% for eligible R&D expenditure	The Act received the Royal assent on 7 May 2019	*Tax Tips Alert*
Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019	• Imposes goods and services tax (GST) on low value imported goods • Ring-fences residential rental deductions	The Act received the Royal assent on 26 June 2019	*Tax Tips Alert*

New legislation ring-fences residential rental property losses

The Taxation (Annual Rates for 2019-2020, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 was enacted on 26 June 2019, bringing with it a suite of changes limiting a person's ability to offset losses from residential property investments against a person's other income (i.e. non-residential rental income).

The rules are effective from the beginning of a person's 2019/2020 income year. This means these rules will apply for the current income year and may result in more taxable income for those who have previously used their residential rental property losses to offset against their other income (e.g. employment income). Instead, residential rental property losses can only be used to offset against "residential income" earned in the year and any excess will be carried forward to the next income year.

We discuss some of the key features of the new rules below.

General application of the rules

The new rules apply to "residential rental property", with the term being defined as "residential land" as referenced in the bright-line test provisions. Therefore, farmland and land used as a business premises are excluded.

There are also several types of property expressly excluded from the new rules, notably:

- the person's "main home"
- property held on revenue account
- property owned by Government enterprises or by companies other than close companies
- property that is subject to the mixed-use asset rules, and
- property provided to an employee for accommodation in connection with their employment.

Residential rental income

A key feature of the new rules is that residential rental property losses can generally only be used against "residential rental income" derived in that income year. The new rules provide a comprehensive list of income that falls within the definition of "residential rental income". The types of income include:

- rental income
- depreciation recovery income
- any income from the sale of the property (if the land sales provisions apply), and
- rental income from property held on revenue account.

Portfolio vs property-by-property basis

The rules can apply on a property-by-property basis or a portfolio basis. The election is made by the person in the year the property becomes their residential rental property. If an election is not made at this time, the portfolio basis (as the default position) will apply for the life of the property.

If the portfolio basis is used, a taxpayer may use the deductions of one property against the income of any of the properties in the portfolio. Additionally, where all of the properties in a portfolio have been taxed on disposal (e.g. under the bright-line rules), any unused deductions existing after the disposal of the final property are no longer ring-fenced and can therefore be used to offset other income of the person.

If the property-by-property basis is elected, each property is looked at separately and therefore the excess deductions from one property cannot be used against the income from another property. Similar to the portfolio basis, if the person has taxable income from the disposal of the residential property, any excess residential property losses that the property has accrued can be used to offset against other income of the person for that income year.

Use of entities to hold property

Where a "residential land-rich entity" such as a company or a partnership is used to hold residential rental property, and debt is used to acquire an interest in that entity, the amount of a deduction that a taxpayer can obtain for interest expenditure is limited to the amount of rental income derived by the properties owned by the entity. A "residential land-rich entity" is defined as being:

- a close company, partnership, or look-through company if more than 50% of its assets by value are residential land, or
- a trustee of a trust whose property includes residential rental property if more than 50% of the trust's assets by value are residential land.

A key point to note is that "residential land" includes the main home. Therefore, if the main home is held by the entity, its value contributes to the 50% asset-value threshold.

Any close company intending to carry forward excess deductions to offset against rental income or income from the disposal of residential property in future income tax years must meet the shareholder continuity requirement for carrying forward company losses (i.e. 49%). Close companies that are part of a wholly-owned group may also transfer excess deductions between other property-holding close companies in the group.

General

Consideration should be given to those with residential rental properties to understand the impact of the new rules on their tax liability for the 2019/2020 income year, including any impact to their provisional tax obligations.

Please get in touch with your usual PwC adviser if you would like to discuss the potential impact of these rules.

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