TAX PRESS

Related Parties Debt Remission

Inland Revenue released (24 February 2015) an officials paper on related parties debt remission. The purpose of the paper is to introduce amendments to the debt remission rules. It is targeted at situations where the cancellation of a debt does not change the ownership and/or wealth of the owner - for instance, the setting aside of debt in the context of a wholly owned group of companies.

Outlined below, by way of summary, is an introduction to the current law, followed by an overview of the proposed amendments as set out in the issues paper. The core proposals will apply from the 2006-07 tax year and while submissions are sought, Inland Revenue will not expend any resources to investigate such scenarios. Submissions have to be made by 14 April 2015.

Current Position

Where a debtor is no longer required to repay a debt, the following tax consequences arise pursuant to the financial arrangement rules - the debt remitted becomes taxable income for the debtor; and the lender does not ordinarily get a deduction for the debt written off, unless the lender is in the business of lending (and is not associated with the debtor). The debt remission income is calculated by what is called a base price adjustment (BPA) calculation.

The BPA calculation is triggered when debt is remitted by the lender as a consequence of the following types of scenarios:

(a) the lender discharges the debtor from making any further payments;

(b) the debtor becomes insolvent or is liquidated;

(c) a creditors' compromise is entered into; or

(d) the debt becomes unenforceable or irrecoverable given the debt is "old".

Where the debt is between family - when the loan is forgiven, debt remission income does not arise (as no BPA is triggered). This is because under the current rules you can discharge a loan owed by a person for whom you have natural love and affection - without giving rise to debt remission income.

"If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has".

- JOHN MAYNARD KEYNES

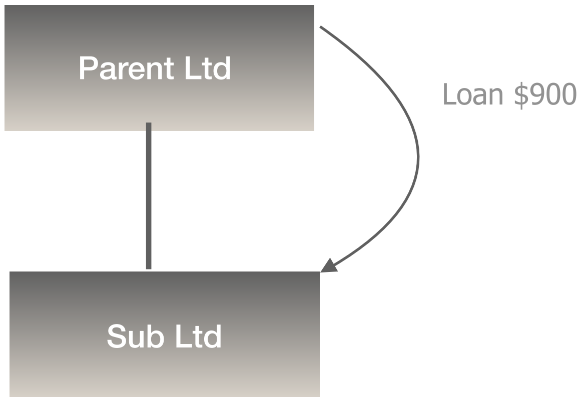
Please note that a person can forgive a loan given to a family trust under this "exception" provided the beneficiaries of the trust only include persons for whom you have natural love and affection. If your family trust has a corporate beneficiary, the natural love and affection carve out does not apply.

A similar exception applies where the loan is between members of a tax consolidated group - the debt remission income in this situation is not taxable if the parties were members of the consolidated group when the lending was provided.

Proposed Changes

The changes are intended to ensure that there is no remission income where related party debt is remitted - as the net wealth of the shareholder(s)/owner(s) remains the same. The following examples are listed in the document which illustrate the practical impact of the suggested amendments. The full document can be found at: http://taxpolicy.ird.govt.nz/news/2015-02-24-feedback-sought-proposed-changes-related-parties-debt-remission-rules.

Example 1

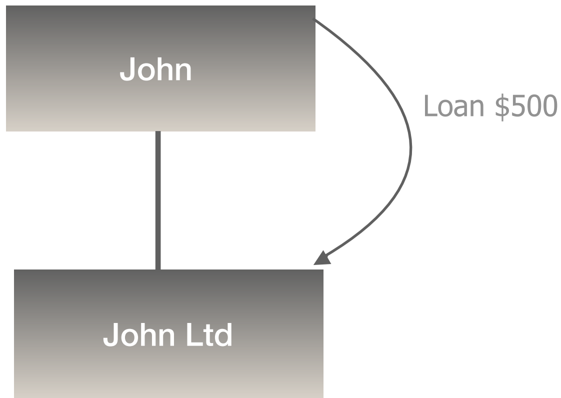


If debt is remitted:

Current position - remission income for Sub Ltd, no deduction for Parent Ltd.

Proposal - no remission income, and no deduction. Treatment made symmetrical.

Example Two

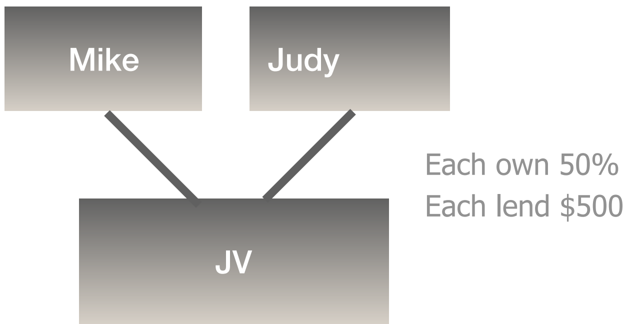


If debt is remitted:

Current position - remission income for John Ltd, no deduction for John.

Proposal - no remission income, and no deduction. Treatment made symmetrical.

Examples 3/4



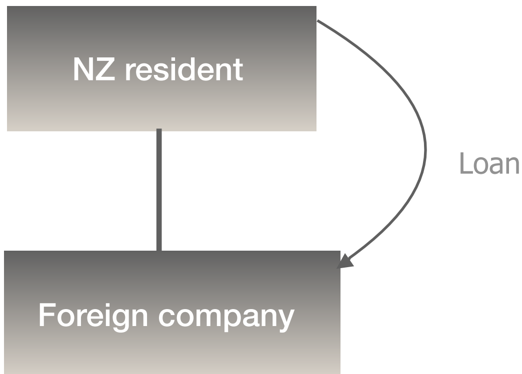
If debt is remitted:

Current position - remission income for JV, no deduction for Mike or Judy.

Proposal - no remission income, and no deduction. Treatment made symmetrical.

Same outcome proposed for partnerships.

Examples 5/6



The proposal is to have no debt remission if a NZ shareholder remits a debt owed by a controlled foreign company (a foreign company controlled by NZ residents).

Also, where a non-resident owns a NZ company, the proposal is that there should not be any remission income for the NZ company if the shareholder remits a loan.

Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill

This bill was introduced to Parliament on 26 February 2015. The key proposals are discussed summarily below. Please note that the bill contains various other remedial matters not discussed below. http://taxpolicy.ird.govt.nz/news/2015-02-26-omnibus-tax-bill-introduced.

"Cash out" R&D losses

R&D start-up companies will be able to claim 28% of their R&D expenditure for any income year. The eligibility requirements are that the company must be a loss making NZ resident and a significant proportion of their expenditure must be spent on R&D. There are additional requirements, for instance, the company cannot be a look through company, the company cannot be part of a group of companies which includes a non-resident company.

The company must meet a wage intensity criteria - which is simply total R&D expenditure divided by the total labour expenditure. The result must be 0.2 or more for the company to be eligible.

The amount of losses to be cashed out will be capped at $500,000 for the 2015-16 year and this will be increased by $300,000 for the next five years to $2m. A company will get the lowest of the following:

(a) the company's net loss for the year;
(b) the company's R&D costs for the year; and
(c) 1.5 times the labour costs related to the R&D for the year.

The "cash out" will be in the form of a tax credit.

The definition of R&D will exclude specific types of spend such as acquiring or disposing land (unless the land is related to a research facility), prospecting for oil, minerals, gas, research in social sciences, arts, or humanities, market research, market testing etc.

The cashed out portion will have to be repaid by the company in certain circumstances:

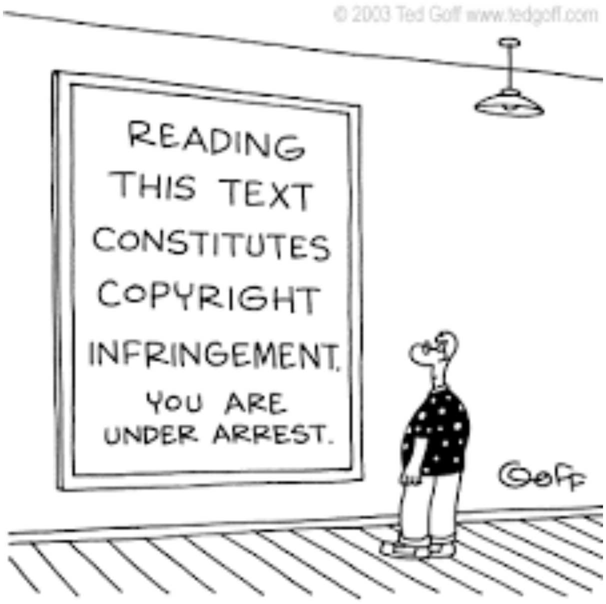
(a) if the company migrates,
(b) it makes a return on investment by transferring the R&D assets;
(c) the company is liquidated;
(d) the company amalgamated; or
(e) 90% or more of the company is sold since the company first cashed out its R&D losses.

Please note that the amount to be repaid will be reduced by the income tax paid by the company from the time it cashed out its losses. There are detailed provisions for the above, and regarding the repayment of losses - contact me directly if you require any additional detail.

Black hole expenditure

A deduction will be allowed for R&D expenditure spent on an intangible asset (recognised as such for accounting purposes) that is not depreciable for tax purposes. This will apply for expenditure so capitalised on or after 7 November 2013.

Depreciable and non-depreciable intangible assets



- Deductions previously claimed for capitalised development expenditure on de-recognised non-depreciable intangible assets - if the intangible asset is sold or becomes useful again - deduction will be clawed back as income. Application 2015-16 year onwards.

- If a taxpayer has created a depreciable tax asset, new section will allow capitalised expenses relating to the asset to be added as part of the cost of the depreciable asset.

- New tax depreciable assets: design registration (and application), copyright in an artistic work that has been applied industrially (as per Copyrights Act).

GST and body corporates

The amendments clarify that the services supplies by body corporates are supplies for consideration for GST purposes. Body corporates have the option to register for GST.

Foreign superannuation

- Foreign super rules to apply to interests acquired by a person who is NZ tax resident under NZ domestic law, but not NZ tax resident under a Double Tax Agreement.

- Re-introduction of the Australian FIF exclusion with respect to interests in registered Australian superannuation schemes if acquired while the person was NZ resident.

- Ensure that the transfer of an interest from one foreign scheme to another still falls within the ambit of the foreign superannuation rules (and not the FIF rules).