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TAX PRESS

Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill

The Government released the above Tax Bill on 3rd May 2016 proposing legislative amendments for closely held companies, the non-resident withholding tax regime and GST. The Bill is a hefty 200 pages (and not the most exciting of reads!). I persevered and outlined below is a summary of the key proposals.

Look through companies

Look through counted owners

For LTC's owned by trusts, when counting the number of "look through counted owners", the rules count the trustee and all beneficiaries that have received LTC income in that year or the previous three years, by way of distribution.

The proposed amendment broadens this so that you need to count the trustee and all beneficiaries who have received any distributions from the trust in the current and preceding three income years. The distributions include beneficiary distributions, capital distributions and corpus.

This will change will apply by reference to income earned from the 2018 income year onwards.

This amendment, in my opinion, is unnecessarily aggressive. It effectively precludes the use of a trust as a shareholder of an LTC.

Other amendments

a. Charities and Maori Authorities can no longer be LTC owners. There is a special grandparenting provision for Maori Authorities who are currently LTC owners.

b. A trust that is an LTC owner cannot make a distribution to a corporate beneficiary. It can have corporate beneficiaries, but the ability to make a distribution is restricted.

c. A trust can continue to make a distributions to beneficiaries that are charities provided the distribution is akin to a donation or the charity is a residual beneficiary.

d. If an LTC is owned, 50% or more, by foreign investors (foreign LTC holder), then foreign income the LTC can earn has to be limited to: the greater of $10,000 or 20% of the LTC's gross income for the relevant tax year. "Foreign LTC holder" is defined by reference to the standard tax residence provisions but will also include any trust that has a foreign settlor or appointor.

e. Amendment to the definition of "look through interest" to allow for the issue of different classes of shares.

f. LTC entry tax calculation to be modified so that the taxable income that arises from this calculation is taxed at the personal tax rate of the shareholder. And for qualifying companies (QC) converting to an LTC, the shareholder pays no more tax than they would if the QC had been liquidated.

g. No debt remission income if an LTC owner or partner remits debt owed to them by the LTC or partnership. This is referred to as "self remission". This change applies from 1 April 2011 and taxpayers can claim any refunds/overpaid tax as a result of this retrospective application.

h. QC status will cease if there is a change in shareholder continuity of 50% or more. Application: 2018 income year onwards.

Related Party Capital Gains

Under current rules, a realised capital gain for a company can only be distributed when the company is liquidated. Further, if the capital gain results from the sale of a capital asset to an associated person, the gain is taxable (unless the capital gain is derived by a close company).

The proposed amendment relaxes this so that capital gains will be tainted (and therefore taxable) only if the gain is realised from the sale of a capital asset by one company to another company, where the two companies are owned by a group of persons with voting interests of at least 85%.

Resident Withholding Tax

a. A company can opt out of deducting RWT when a fully imputed dividend is paid to corporate shareholders.

b. Changes to the RWT rules so that when cash and non-cash dividends are paid, RWT will be calculated as if the cash and non-cash dividends are a single dividend. RWT will be payable only apply if the cash dividend is equal to or greater than the RWT liability calculated under this rule.

Non-resident Withholding Tax

Non-resident passive income arises only in respect of "money lent".

The Bill proposes an extension to the definition of "money lent", for related party transactions, to include any amount provided to a NZ resident by an associated non-resident under a financial arrangement where the NZ borrower will incur expenditure under the financial arrangement rules.

For this purpose, a new definition, "related party debt", is proposed which means all financial arrangements where a non-resident provides funds directly or indirectly to a NZ resident (or a branch of the NZ resident) where the NZ resident will get a deduction under the financial arrangement rules. Related party debt will also be ineligible for approved issuer levy (AIL).

NRWT will be payable when the interest deduction is claimed by the NZ borrower, if the parties are associated.

To target scenarios where interest is accrued but payment is significantly deferred, a deferral calculation is introduced that has to be done for all related party debt.

If the deferral calculation results in non-resident financial arrangement income, NRWT will apply on an accrual basis. The calculation does not have to be done if the total expenditure from the related party debt is less than $40,000. For this purpose, expenditure from related party debt for all entities with at least 66% commonality of ownership is included.

Approved Issuer Levy

For AIL to apply, payments must be made by an approved issuer borrower to a non-associate under a registered security - security being registered pursuant to the Stamp and Cheque Duties Act 1971.

The Bill proposes three categories for a security to be classified as a registered security. The first two categories are NZ borrowers and non-resident lenders who IRD considers are not treating associated person transactions incorrectly and IRD can very easily determine that the parties are not associated.

And the third, where NZ resident is expected to make payments totalling at least $0.5m in a year to non-residents.

For securities that are already registered, the new rules will apply from 1 April 2018. That is, from 1 April 2018 you have to apply the above tests to determine whether the security in question continues to be registered.

Goods and Services Tax

Capital raising expenses

The supply of debt or equity securities are classified as financial services and are exempt supplies for GST. As such, you cannot claim input tax deductions for costs related to capital raising.

The proposed amendment will allow for input tax deductions to be claimed for expenses related to capital raising or the payment of dividends/interest/amount of principal.

This does not apply to businesses that principally supply financial services and is targeted at businesses making taxable supplies who go to market to raise capital whether by way of debt or equity.

"Directly connected with"

Under the current Act, the supply of services made to non-residents "directly connected with" NZ land is subject to GST. On the other hand, the supply of services "directly connected with" land outside NZ is not subject to GST.

There has been confusion re how "directly connected with" should be interpreted. For instance, it is agreed that landscaping is directly connected with land. But, what about professional services (such as legal services, architectural work) that do not physically impact the land? The Bill proposes amendments to clarify that professional services related to land are "connected" with the land.

The Bill proposes the insertion of additional wording so that professional services provided and which relate to land will be subject to GST if the land is in NZ; and not subject to GST in the case of land outside NZ if the services:

"are in connection with land or an improvement to the land, that is located in New Zealand (or outside NZ), and are intended to enable or assist a change in the physical condition, ownership or other legal status of the land or improvement".

The Bill and Commentary can be found using the following link: Tax Bill May 2016.