

NEWSLETTER

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You versus your Trust

It is common from a layman's perspective to not appreciate the relevance of treating separate legal entities as separate. Where expenditure is incurred to derive income, it is typically deductible for income tax purposes to the person that derived the income. Documentary evidence should be held that reflects this connection to ensure the expenditure comprises an allowable deduction. The High Court recently considered this issue in the decision of *Wong v Commissioner of Inland Revenue* (2018).



In *Wong v CIR*, the taxpayer was an accountant by profession. He derived income from a consultancy business and two rental properties. He was also trustee of his family trust that derived rental income from a third property. Mr Wong financed both the consultancy business and rental properties through a number of loans and credit facilities in his personal name.

Despite reminders from Inland Revenue (IRD), Mr Wong failed to file personal income tax returns for the 2013 and 2014 tax years and IRD raised default assessments for those years of \$84,273.10 and \$39,549.65, including penalties.

Mr Wong disputed the assessments, contending that the correct tax position was \$951 in 2013 and nil in 2014, on the basis that interest deductions were available in respect of all three rental properties. IRD argued that interest was only deductible in respect of the two properties owned personally. However, the interest incurred for the trust property could not be deducted against his personal income as it had been incurred by the Trust, as owner of the property. To successfully challenge IRD's assessments in the courts, the

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onus of proof rests with the taxpayer to show how, and by how much, the IRD's assessments are wrong. With respect to the interest incurred in relation to the trust property, the TRA found in favour of IRD, emphasising that Mr Wong had failed to prove the outstanding debt and interest was paid in relation to properties owned by him personally.

The taxpayer appealed to the High Court, who found the TRA's decision correct in all respects.

A shortfall penalty, for taking a 'grossly careless tax position' was also upheld. Mr Wong contended that no shortfall penalty should apply

once tax losses are taken into account i.e., no cash tax liability existed due to his personal tax losses. However, shortfall penalties are calculated based on the net shortfall, as though tax is payable and the shortfall penalty was upheld.

From a commercial perspective, it can make sense to stand back and look at a group of entities as though they are a single person, especially when they are economically owned by a single person, however, IRD and the Courts do not take the same approach.

GST and land sales

In 2011 the GST Act was amended to prescribe that a supply of land between two GST registered parties was subject to a rate of 0% if the land was to be used by the purchaser to make taxable supplies and not as a principal place of residence.



Given the change reduced the GST rate to 0% it is fair to assume it should have simplified how GST applies, i.e. there wouldn't be any. However, in practice the change continues to cause problems both from a contractual and technical perspective. This led to Inland Revenue (IRD) issuing additional guidance in 2017. However, problems persist. We have outlined two examples below.

Under the GST Act, a purchaser is required to notify the vendor of their circumstances so that the vendor can establish whether or not to zero-rate the sale. In practice, this occurs by completing Schedule 1 of the Auckland District Law Society (ADLS) Sale and Purchase (S&P) agreement. However, there are instances where the schedule is not completed at all, in which case there is no 'agreement' between the parties regarding how GST applies.

If a GST registered purchaser does not complete the schedule and a vendor mistakenly charges GST at 15% because they assume the purchaser is non-registered, the purchaser will understandably apply to IRD for a GST refund. If IRD review the transaction and determine it

should have been zero-rated IRD will decline the refund. Instead, the purchaser will need to seek a refund from the vendor. The vendor will also need to apply for a refund (of the GST) from IRD, to fund the repayment to the purchaser.

Another scenario is where Schedule 1 of the S&P has not been completed at all and the vendor incorrectly zero-rates a sale on the assumption that the purchaser is GST registered etc. In this situation, GST will need to be paid, but there is currently uncertainty regarding who is liable. A provision exists that deems the purchaser to be liable if a transaction has been incorrectly zero-rated. However, it is unclear whether this provision applies in all situations or only when the vendor and purchaser agreed what the GST treatment should be, which is later found to be wrong. If the vendor is held liable and the price has been expressed in the S&P as "including GST", the vendor is worse off. If the purchaser is held liable and the S&P was "including GST", it becomes a question of whether the purchaser can seek a partial refund of the purchase price from the vendor to fund their GST liability.

It is extremely important to ensure the S&P is complete and correct. Costly mistakes can be avoided simply by following due process. If you are unsure, please ask your advisor.

When is a gift not a donation?

If an individual pays "...a monetary gift of \$5 or more..." to a charity they are able to claim 1/3rd of it back from Inland Revenue (IRD). Prior to 1 April 2008, individuals could only claim donations of up to \$1,890, i.e. a refund of \$630. The

coalition Government at the time removed this limit and increased the threshold to the amount of taxable income, to incentivise individuals to give charitably.

For the average New Zealander, limiting donation claims to the amount of a person's taxable income is of no consequence. However, some high net worth individuals make donations that exceed the amount of their taxable income, thereby entitling them to large refunds.



cash payment, provided that it was a gift of a specific sum and was not a chattel or property item. Judgement was upheld for Mrs Roberts.

For example, a large donation could be made to help fund an important capital project of a charity, such as the construction of a new building for the homeless. The question then becomes how to structure a large donation, to ensure a donation rebate can be claimed. The problem lies in the legislation itself. Although the regime is to incentivise charitable giving, the legislation can be narrow in scope. The donation claim is restricted to monetary gifts made in an income year, whilst assets, such as "food" donated to the homeless, does not qualify for the tax credit.

The High Court decision in *Roberts v Commissioner of IR* examined a donation rebate that was in the form of a loan forgiveness. Mrs Roberts had made a cash loan to a charity of \$1.7m. The loan was subsequently being forgiven across multiple years and claimed as a donation rebate. IRD considered that a 'debt forgiveness' was not a charitable gift within the meaning of the current legislation because it was not a 'cash' gift. Judge Coleman decided in favour of Mrs Roberts and confirmed that a monetary gift did not require

The forgiveness approach is no different, for example, to Mrs Roberts making the loan and then making cash donations in future years that are used by the charity to repay her loan. In substance, cash has been paid by a private individual to a charity – being the purpose of the regime.

In a surprise move, when the Taxation (Annual rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill was reported back from the Finance and Expenditure committee (FEC) on 18 January, IRD had included a recommendation that the current legislation be amended to prescribe that donations need to comprise a "gift of money", thereby legislating against the decision in *Roberts*. By recommending the change at such a late stage of the enactment process, it skips the public consultation phase. IRD have justified the change by asserting that the 2007 re-write of the Income Tax Act changed the meaning, and they are merely changing it back.

Rather than accepting IRD's view, it would be nice if the FEC had looked at the issue more 'charitably'.

Winding up a company



If a company does not file its annual return with the Companies Office, it may be struck off from

the Companies Register. This is sometimes used as a 'short-cut' method, rather than completing the short-form company liquidation process.

However, this approach comes with some risks, for example, if a company is struck off the register whilst it has tax credits owed by Inland Revenue (IRD), the tax refund is effectively forfeited and will not be paid to the company nor its shareholder(s) unless the company is reinstated.

Similarly, if a struck off company is still named as the owner of land (on the title), the company has to be reinstated in order to transfer the land to its correct owners and then wound up again.

Although the process of winding up a company can be lengthy, to minimise risk for both the

business and its stakeholders it is recommended that the correct procedure is followed.

The process should always be commenced with a special shareholders resolution, which provides legal evidence that the majority of shareholders agree to the wind-up. It represents the point from which capital gains may be distributed tax free and is a commonly requested by IRD if they happen to review the wind-up process.

Any outstanding company liabilities are then satisfied, including trade creditors and anything owed to related parties. Surplus assets are distributed to shareholders, ensuring any legal formalities are observed depending on the type of asset (e.g. updating the land registry for any land / buildings).

For tax purposes, distributions to shareholders may be non-taxable to the extent they are comprised of share capital or capital gains, however excess amounts may comprise taxable dividends to the shareholders.

The company should complete its final GST and income tax returns (etc.), pay any outstanding tax liabilities and then de-register with IRD. A request is also made to IRD to provide written approval for the company to be removed from the companies register.

With no assets or liabilities, the company bank account can be closed before the final stage of passing a further shareholders resolution resolving to make an application to the

Companies Office to remove the company from the Companies register. The Companies Office gives public notice of its intention to strike the company off in the New Zealand Gazette. Provided no objections are received within 20 working days from the date of the notice, the company is struck off the register.

Although the process sounds prescriptive, incurring the cost of having it done correctly could save money in the long run.

Snippets

GST on low value imported goods



GST is intended to be a broad-based tax applying to goods and services consumed in NZ, however under the current system not all goods and services are captured. Specifically, GST is not currently collected on imported goods worth \$400 or less. Historically, it was thought that the administrative cost of collection would outweigh the tax revenue collected, however the import market has grown giving rise to increasing concern NZ suppliers are disadvantaged in comparison to offshore suppliers.

Following in the footsteps of recent Australian law changes, a Bill was introduced into Parliament in December 2018, the Taxation (Annual Rates for 2019-20, GST Offshore Supplier Registration, and Remedial Matters), that seeks to level the playing field.

The Bill, intended to be effective from 1 October 2019, proposes to apply GST to goods valued at \$1,000 or less (excluding tobacco and alcohol) that are delivered to a NZ address from overseas. Offshore suppliers will be required to return NZ GST if their total supplies to NZ exceed \$60,000 in a 12-month period.

So what does this mean for NZ consumers? They will likely have to pay GST on low-value goods imported from overseas, while NZ businesses are now on a more level playing field with their overseas competitors.

Sugar Taxes

With obesity becoming an ever increasing problem in New Zealand, there is regular debate regarding the effectiveness of a sugar tax to curb the problem. There is a lack of consensus on whether such a tax may be beneficial, yet sugar taxes are nothing new.



100 years ago in 1919, with the First World War nearing conclusion, politicians in the United States decided that taxing ice-cream sodas, sundaes, juices, lemonades and other sugary drinks would offset the tax revenue lost from alcohol sales once the nationwide prohibition came into effect.

However, one year after introduction of the sugar tax, following the conclusion of the war, the tax was scrapped. The USA still faced record levels of war debt, yet the soda tax was so unpopular with the American people that it wasn't a viable option.

Although the 1919 soda tax did not have health objectives in mind, it is reasonable to conclude that soda was not something the American people wanted their politicians messing with.

After 100 years, the situation in New Zealand is only getting worse with 32% of adults considered obese, what are our options? During the First World War, rationing was a way to ensure people got what they "needed"...

End of Financial Year

For most of our clients their current financial year ends on 31 March 2019.

Accountants terminology around this date can be confusing. Accountants often refer to the financial year by the year in which the balance date falls. Thus the financial year that ends on 31 March 2019 is referred to as the "2019 year".

A quick reminder of some matters to consider heading towards the end of financial year –

- Bad debts – before your balance date you should review your Accounts Receivable (AR) ledger for any bad debts. In order for a bad debt to be claimed you should carefully record why you regard the debt as bad. The debt must be physically written off in your AR ledger on or before your balance date. If the debt is subsequently recovered then it should be recorded as "Bad Debts Recovered", not sales.
- Stocktakes – if you have trading stock then you will need to do a stocktake on your balance date. The stock should be recorded at cost excluding GST. Farmers should carefully record all livestock on hand – refer to the Farming Questionnaire on our website for categories.
- Financial records – you should check your records to ensure that they are up to date and complete (i.e. all bank accounts are reconciled, all bank statements are on hand etc.).
- Accounts Payable (AP) – if you are not running an electronic AP ledger system then you should carefully record all invoices that are dated on or before your balance date but are not paid until after balance date.
- Client Questionnaires – these may be obtained from our website. We strongly recommend that all clients complete the relevant questionnaires and forward them to us with their financial records. A well completed questionnaire can lead to a speedier and more cost effective solution all around.

Payday Reporting

A final reminder to all employers that payday reporting is mandatory as from 1 April 2019, with very few exceptions.

If you are at all unsure as to how this affects you as an employer please refer to our previous

newsletters and/or the IRD website (www.ird.govt.nz).

Please note that penalties apply for non-compliance.

We recommend that you consider your position now and, if possible, register for payday filing by 25 February 2019 so that you go live on the new system from 1 March 2019 as we suspect that the IRD system may be overloaded with queries in the early part of April 2019.

AML/CFT Act

As from 1 October 2018 accountants became subject to the provisions of the Anti-Money Laundering/Countering Financing of Terrorism Act (AML/CFT Act).

Part of our requirements is that we hold identity documents for our clients, especially where we act as a trustee of a trust, a director of a company, registered office of a company, receive client funds, pay expenses on behalf of a client etc. It is arguable that we even require it where we give instructions to the IRD to correct the account to which a payment has been credited!

For existing clients as at 1 October 2018 we will be obtaining these documents over the next year. For new clients we will be obtaining these upon engagement.

The documents that we typically require are –

- Copy of current passport or copy of current drivers licence and a credit card or eft-pos card showing the client name.
- Copy of a utility invoice or bank statement showing the client name and residential address dated within 6 months of production to us.

Please understand that we are not doing this to be difficult but because it is a statutory requirement. The penalties for us for failing to comply are significant. So we ask for your co-operation when we request these documents.

If you have any questions about the newsletter items, please contact us, we are here to help.