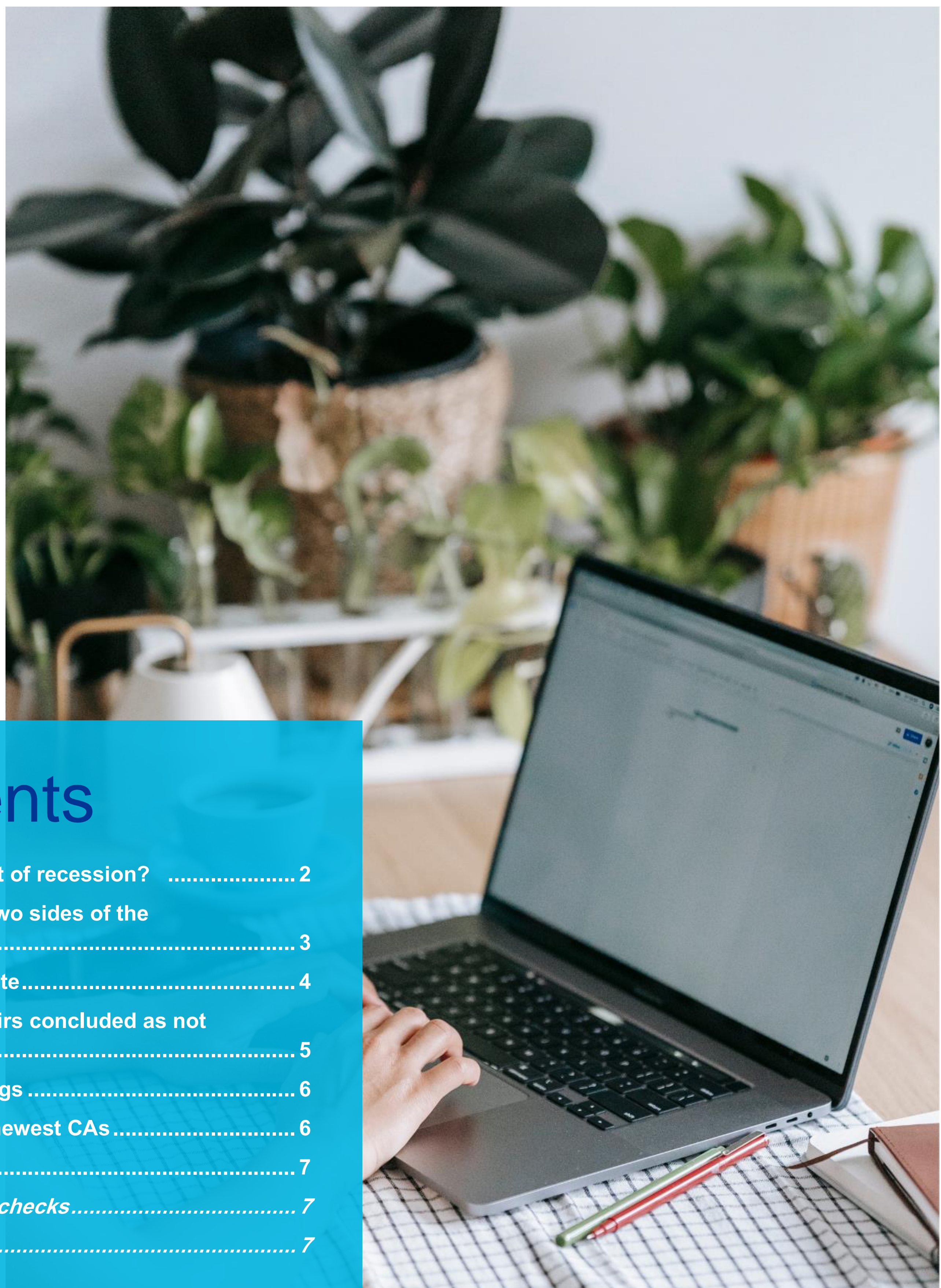
PKF EDGE

ISSUE 11 | SPRING 2023

PKF Hamilton



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Tax ourselves out of recession?

The buoyant covid subsidy funded days are behind us, New Zealand has entered a 'technical' recession. This was reinforced by the recent announcement that New Zealand's corporate tax paid was almost 11% down in the 11 months to May relative to Government expectations. A drop in the corporate tax take reflects the declining profits of businesses, coinciding with a decline in output. While profits have declined, there is little to ease the tax burden for businesses with no relief measures in place in a volatile market.

From all the industries feeling the pinch of economic downturn, the construction sector has arguably been hit hardest. As property prices decline, construction costs continue to rise sharply, impacting margins and the ability of property focused businesses to service debt.

Many builders and property developers will be holding land that has dropped in value within months of acquisition. By valuing closing stock at "market selling value" most businesses are able to claim a tax deduction for the drop in the value of their inventory prior to sale, as long as the value is supported by market data. However, as land is specifically excluded from the trading stock rules, businesses that derive income from the sale of land cannot deduct losses in value until the land is sold. The misalignment in treatment is arguably a kick to an industry that is already down.

One of the temporary tax measures introduced in response to Covid-19 enabled tax losses to be carried back to the prior year to recoup previously paid tax. A strong 2022 financial year followed by a volatile 2023 raises the question whether a similar loss carry back scheme could be implemented now to cash out current year losses when businesses need it most. With the next 12 months showing little signs of an economic boom, it could be a few years before some businesses can claim current period losses under the current tax rules.

With operating costs growing, investment in capital is being reconsidered and potentially delayed. The ability to claim an immediate tax deduction for small capital items could incentivise businesses to proceed with projects. The reintroduction of a higher threshold for low value assets at $5,000 or more is another option for the government to encourage investment in productive assets that create more opportunities. This could be further extended similar to the relief measures Australia provided where small businesses had the potential to temporarily write-off assets to the value of $150,000 encouraging investment at a greater scale.

While the timeframe for such write-off's has ended in Australia, similar to New Zealand, these relief measures during the pandemic illustrated how tax can be used to drive business investment and reduce the tax burden on businesses during an economic downturn.

Tax policy from two sides of the political aisle

Given that either Labour or National are likely to enter into coalition agreements of some form with the Green Party and Act, respectively, and the tax policies of the two main parties are more 'vanilla', it is worth reviewing the tax policies of the two minor parties as this is where unexpected change may come from.

The Greens have taken the approach of increasing tax across the board. Their key policy is a 2.5% annual tax on net wealth above $2m ($4m for couples). This would apply to most forms of assets, with things like property and shares valued based on their market value. They have indicated that taxpayers would have the option to defer the payment of the wealth tax until the asset is sold, to assist those who don't have the cashflow necessary to pay the tax. They also propose an annual 1.5% tax on all assets held in private trusts to ensure taxpayers cannot avoid the wealth tax through sheltering assets in a trust. No minimum asset value exists before the tax applies, meaning those who own an average family home in a trust would be caught by the tax, despite having net wealth below $2m.

In contrast, Act is looking to reduce taxes levied on assets. Act has opposed the bright-line test since National introduced it in 2015, with Seymour describing it as an "acorn of a capital gains tax". Currently, any residential investment property that is sold within 10 years of purchase (that is not a 'new build') is subject to the bright-line test and any capital gain will be taxed. They plan to abolish the test, as well as reinstating interest deductibility for residential rental properties.

When it comes to marginal tax rates, the Green Party are looking to introduce a new top tax rate of 45% on income above $180,000, as well as reducing the brackets such that the 39% rate kicks in at $120,000. A tax free threshold would also be introduced between $0 - $10,000.

Act wants to simplify things, eventually reducing down to a two-tier system. Income from $0-$70,000 would be taxed at 17.5%, and all income above $70,000 would be taxed at 28%. They note this would result in low and middle income earners becoming worse off in many cases, so would also introduce a specific tax credit for these earners to offset this.

Other notable policies are that the Greens would increase the corporate tax rate back to 33%, and Act would divert emission trading scheme revenues into an annual tax refund for every New Zealander.

Looking at these policies, a clear dichotomy exists between the two parties. Execution of the policies will be tempered by their respective coalition partners, but as more voters stray from the centre who's to say what will make it through to tax policy when the new government is formed.

39% Trust Tax Rate

On 18 May 2023, the government introduced the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill. The Bill includes draft legislation that will see the trust tax rate increase from 33% to 39% from 1 April 2024, thereby aligning it with the top personal marginal tax rate.

Between 2000 and 2010, the top personal marginal tax rate was also set at 39%. Throughout that period, the trust tax rate remained at 33%. The government has cited the recent re-introduction of the 39% top personal tax rate as the reason for the increase in the trust tax rate. The commentary to the bill states: “Aligning the trustee and top personal tax rates at 39% would help ensure that trusts cannot be used to circumvent the top personal tax rate. This would improve the fairness and progressivity of the tax system, protect the revenue base from erosion, and improve the Government’s ability to raise revenue.”

Much like when the top personal marginal tax rate increased to 39%, taxpayers will no doubt consider ways to minimise their exposure to the 39% rate. However, unlike the top personal rate, the 39% trust rate will apply from the first dollar a trust derives. This means the scope of the change is likely to be broader without active planning. We are likely to see a significant increase in beneficiary distributions. It is common for trusts to distribute income to their beneficiaries to utilise their lower marginal tax rates. However, because the 39% personal tax rate doesn’t apply until $180,000, trusts could commence making large distributions to beneficiaries. When we consider that trusts often distribute to children, we could see many young adults receive distributions of up to $180,000. This will have flow on effects to student loan and provisional tax obligations.

Between now and the new rate coming into effect, there is still the outcome of the general election to be decided. This is likely to mean most people will wait until the outcome is known. However, if the new trust rate does come into effect, large dividends are likely to be declared to extract retained earnings from companies owned by trusts, at a rate of 33%, sheltering them from having to pay the 39% rate on these earnings in the future. A similar trend was seen prior to when the 39% personal marginal rate came into effect.

Some taxpayers will question whether this change disqualifies trusts as a viable structuring option. However, the reality is that the asset protection and succession planning advantages still exist, irrespective of the tax treatment.

Leaky home repairs concluded as not deductible

The leaky homes crisis represents one of the most severe problems faced by New Zealand's property sector and continues to cause stress and anxiety for those affected. Adding to the uncertainty for rental property owners has been the question of whether repair costs are immediately deductible as 'repairs and maintenance' (R&M).

Inland Revenue has assisted by providing guidance on determining whether repairs are deductible. The 2012 Interpretation Statement 'IS 12/03 Income - deductibility of repairs and maintenance expenditure - general principles' includes specific examples, but the issue is very fact specific and a matter of judgement.

Illustrating the continued uncertainty, Inland Revenue recently released Technical Decision Summary 23/07: Whether expenditure to resolve weathertightness issues is deductible. The TDS covers a dispute regarding leaky home expenditure deducted by a taxpayer and the decision by the Tax Counsel Office (TCO).

The dispute concerned a taxpayer who owned a rental unit within a block of six units, which were all connected by inter-tenancy walls. The block was also a part of a wider complex, consisting of other similar blocks. The unit in question required remediation work to resolve weathertightness issues.

While the property was untenanted, the remediation work was carried out by the body corporate and paid for by the taxpayer via a special levy. Simultaneously, the taxpayer also incurred expenditure for their unit to be painted.

The question was whether the capital limitation applied to deny the deductions claimed by the taxpayer in relation to the remediation and the painting. Inland Revenue asserted that the entire cost (including the painting) was capital, as the remediation work involved a reconstruction of the whole asset, or at the least, changed the character of the asset.

Conversely, the taxpayer argued that the expenditure incurred was deductible R&M as the remediation work was mostly limited to certain portions of the inter-tenancy walls and decks, while the painting comprised ordinary repairs and maintenance expenditure.

The TCO considered three relevant elements:

- Whether the work resulted in the reconstruction, replacement, or renewal of the asset, or substantially the whole of the asset?
- Whether the work done had the effect of changing the character of the asset?
- Whether the work was part of one overall project or was a series of projects that merely happened to be undertaken at the same time?

The TCO concluded that in the context of the remediation, the relevant asset was the block, given that the work was undertaken by the body corporate on a block-by-block basis and was not carried out solely within the boundaries of the unit. The work changed the character of the block due to the proportionally high costs, and the structurally significant improvements to the affected areas, which were important to the operation of the asset.

Hence, the capital limitation applied to deny a deduction for the remediation work. Conversely, the painting work was undertaken separately from the remediation work and considered deductible R&M.

Free Xero Trainings

Exciting news! We are thrilled to invite you to our upcoming FREE Xero trainings. Take full advantage of this amazing opportunity to enhance your skills and unlock the true potential of Xero's cloud-based accounting software.

Join us for a series of interactive sessions where our expert trainers will walk you through the ins and outs of Xero, from automating data integration to creating comprehensive business reports. Learn how to streamline your financial processes and gain valuable insights that will empower your decision-making.

Don't miss out on this chance to level up your business game. Spaces are limited, so make sure to secure your spot by registering now **HERE.**

We can't wait to see you at the trainings!

Congratulations to our Newest Chartered Accountants!

Join us in giving a round of applause to Tash, Emma, Jason, and Sapna from our Business Advisory and Audit teams, who have recently achieved the prestigious milestone of becoming Chartered Accountants!

We are immensely proud of their dedication, hard work, and commitment to excellence that has led them to this significant achievement. Their expertise and professionalism continue to elevate our services and provide unmatched value to our clients.

In addition to our newly crowned CA's, we are thrilled to announce that one of our Directors, Ali Nation, was also awarded a well-deserved fellowship. This esteemed recognition is a testament to Ali's exceptional career achievements and her contributions to business, the accounting profession, and our community. Congratulations, Ali - we couldn't be prouder of you!

(From left to right) Tash, Jason, Ali, Emma and Sapna

Snippets

GST Registration checks

A standard data policing check completed by Inland Revenue is to review taxpayer GST filing patterns to identify taxpayers that are GST registered, but perhaps shouldn't be.

In order to qualify for GST registration, a taxpayer needs to be conducting a "taxable activity". This comprises a continuous or regular activity that involves making a supply of goods or services for consideration. This is a different test to whether a person is operating a "business" for income tax purposes, as it does not require an intention to make a profit.

A person is required to register for GST when the value of their sales exceed or are expected to exceed $60,000 in a 12 month period. But this issue is not about sales volume, because a taxpayer can voluntarily register for GST if sales are below this threshold.

The issue is whether the activity has stagnated to the point there is either no or very low activity levels, or sales have declined to the point where it suggests the activity has stagnated.

On deregistration, assets retained are deemed to be sold, which can give rise to a cash cost. But if reviewed by Inland Revenue there is a risk they may determine the GST registration should be cancelled at a past date or that the entity never qualified for GST registration – thereby requiring past GST refunds to be paid back. Knowing that a 'knock on the door' might be coming, it is worthwhile to pre-emptively consider whether an entity you are responsible for should not be GST registered.

Super profits

Last year, the Green Party hit the headlines for suggesting banks, fuel companies, supermarkets, building products suppliers and energy generators/retailers should pay tax on super profits. So, as we go into the election, we should give some thought as to whether some new innovative taxes are warranted.

For example, in Canada, kids cereal manufacturers have tax exempt status if their cereal contains a free toy. California was the first US State back in 1991 to apply California State Income Tax to out-of-State athletes that played in California, colloquially known as "jock tax". Today, over half of the US States have a jock tax. To protect the over harvestation of blueberries, the US state of Maine charges a small tax per pound of blueberries harvested.

So, if we had the opportunity, what would we do….

- Do we provide the All Blacks and Black Ferns a personal tax rebate each time they win, or do we increase their tax rate when they lose.
- Should politicians get taxed each time they don't give a clear concise answer – a maximum percentage might be needed for that one.
- Tax fast food vendors each time they forget part of an order.
- Tax weather forecasters each time it rains on a predicted 'sunny' day.
- Tax cars that speed up in passing lanes.

The ideas are endless..

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

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