# TAX TODAY

## RESIDENCY RELIEF - COMMON SENSE PREVAILS IN HIGH COURT

The Inland Revenue's tax-take arsenal has been depleted following the successful appeal by a former soldier, Mr Diamond, in the High Court decision in *Diamond v Commissioner of Inland Revenue* (2014) 26 NZTC 21,093.

In December last year, the Taxation Review Authority (TRA) held Mr Diamond, who left New Zealand permanently in 2003 to work in various overseas locations as a security consultant, retained a permanent place of abode in NZ and was therefore a NZ tax resident. Shortfall penalties were also applied on the basis that Mr Diamond had taken an unacceptable tax position by not paying tax in NZ on the basis that he was a NZ tax resident.

Further factual information relevant to the TRA decision included the following:

- Mr Diamond's ex-wife and children continued to live in New Zealand;
- An investment property was originally purchased for his ex-wife and children to live in. His name was on the title to secure finance, and he made half of the mortgage repayments in lieu of child support payments;
- When his ex-wife relocated to a new property, he acquired her half share in the property, which was subsequently rented to third parties;
- Mr Diamond visited NZ every five to six months.

In arriving at its decision, the TRA considered that the investment property was available to Mr Diamond as a "dwelling" (the availability of a dwelling being a pre-requisite to having a permanent place of abode in NZ). This was because he legally owned the property and even though it was tenanted, he could give them notice should he have wanted to return to NZ.

The TRA cited Case *Q55* as authority for applying a two-step test for determining whether there was a permanent place of abode. It held that: the property was available for him to live in; and that he could return and live in the property were he to move back to NZ. His connection to the property, the locality, and NZ in general were relevant factors in relation to the second limb of the test

Mr Diamond appealed to the High Court. The High Court held that *Q55* had been applied incorrectly and that the facts differed significantly. Case *Q55* involved a professor who rented out his property while he was overseas on sabbatical leave. Importantly, the professor lived in the property immediately before departure and on his return. The decision provided authority that a person's place of abode will not cease simply because their dwelling has been made available for rental.

The facts of Mr Diamond's case were quite different. The High Court specifically commented that:

- The ordinary meaning of the term permanent place of abode is "to have a home in New Zealand";
- In the context of Mr Diamond, the property

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- in question was neither used as a home by him at any time, nor was it intended to be used as his home at any time in the future;
- The use of the property has consistently been one of investment (for almost 20 years);
- It was acknowledged that Mr Diamond had other ongoing personal connections to New Zealand. However in the absence of the property having any of the characteristics of a permanent place of abode, those other connections did not alter the conclusion reached.

Accordingly the High Court allowed the appeal.

We welcome the High Court decision and consider it a very sensible outcome. The TRA created a significant degree of uncertainty over how far the Inland Revenue could go, and how low the threshold was, in determining whether a person had an available dwelling in New Zealand. The High Court decision will be welcomed by many Kiwis living overseas who have retained investment property in New Zealand.

Fundamentally, we agree that in order to have a "permanent place of abode" in New Zealand a person must have "a home in New Zealand"; and that a "home" is to be distinguished from investment in bricks and mortar. In our view, the High Court decision provides more clarity and common sense when interpreting tax residence in terms of the permanent place of abode test.

Given the conclusion on the permanent place of abode issue, the High Court did not need to consider whether Mr Diamond had adopted an unacceptable tax position in filing tax returns in NZ on the basis that he was not a NZ resident. However, the High Court commented that if it had been necessary it would have had little difficulty in concluding that Mr Diamond had not taken an unacceptable tax position.

The case is indicative of the Inland Revenue's current approach of seeking to impose shortfall penalties in cases that are highly technical in nature and/or where it is simply inappropriate to do so on the facts.

It will be interesting to see if the Inland Revenue reconsiders aspects of its recently finalised residency interpretation statement (IS 14/01) as the High Court decision raises some questions over aspects of the analysis in IS 14/01. Given that residency disputes can be very costly to deal with in terms of time, actual tax cost, penalties, interest and adviser costs, it would be very useful for the Inland Revenue to clarify its position following Mr Diamond's win in the High Court so that taxpayers have a better idea of how Inland Revenue Operations will interpret the meaning of permanent place of abode going forward.

*Postscript - We understand the Inland Revenue will be appealing the High Court decision. That, unfortunately, will leave us in limbo re the ambit of the permanent place of abode test for sometime yet.*

# ARE YOUR EMPLOYEES RECEIVING THIRD PARTY FRINGE BENEFITS?

In September this year, Inland Revenue released a draft Public Ruling PUB0204: "Fringe benefit tax — provision of benefits by third parties" for public consultation.

The draft ruling considers when a benefit provided to an employee by a third party will be treated as a taxable fringe benefit. However, the ruling does not cover situations where an employee's remuneration is reduced because a benefit is provided by a third party (e.g. a salary sacrifice scenario). In other words, there cannot be any trade-off between the benefits provided and the remuneration that would otherwise be received by the employee, or any difference between the remuneration levels of employees who receive benefits and those who do not.

The ruling provides that the provision of a benefit by a third party will be considered to be a fringe benefit in the following circumstances:

- Payment is made (directly or indirectly) by the employer to the third party to compensate for the benefit being provided,
- The employer requests (other than merely initiating contact) the third party to provide the benefit,
- There is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employee,
- The employer and the third party are associated parties and there is a group policy (formal or informal) or any other agreement that employees of the group will be entitled to receive benefits from other companies in the group.

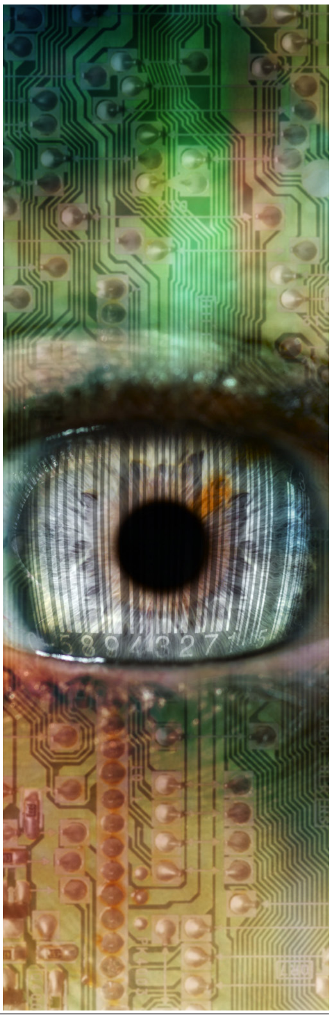
The ruling also includes scenarios where the provision of a benefit by a third party would not usually be considered a fringe benefit. For example, there is not likely to be a fringe benefit if the employer merely agrees to make known the availability of the benefit, or if the employer has done no more than initiate contact or discussions with the third party.

# NZ JOINS GLOBAL CRACKDOWN ON TAX EVASION

On 29 October 2014, Revenue Minister Todd McClay announced New Zealand's timetable for participation in a global automatic exchange of information initiative aimed at cracking down on tax evasion.

He said that "Multinational companies that use base erosion and profit shifting (BEPS) measures to avoid tax is a global problem – and we are committing to joining other OECD countries in finding a global solution. New Zealand intends to align its timetable with Australia's and begin exchanging information on a voluntary basis from 2018, aiming for mandatory reporting in 2019. This will give New Zealand's financial industry enough time to comply with the initiative. The automatic exchange of information initiative will set a global standard for sharing information. It will operate much like the recently introduced US Foreign Account Tax Compliance Act where financial institutions will provide information on account holders' financial assets to their local tax authority."

Mr McClay also said that New Zealand is firmly supportive of this global move to counter evasion. "Tax evasion respects no borders so global co-operation is the way to combat it. Sharing information is a powerful weapon in that fight".



# NEW RULES FOR DEREGISTERED CHARITIES

The Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 introduced new tax rules for charities which have been removed from the register of charitable entities.

An officials' issues paper, "Clarifying the tax consequences for deregistered charities", was released in July 2013. The paper discussed problems with the current tax treatment of deregistered charities, and suggested enacting new rules to deal with their change from tax exempt to tax-paying status.

A "deregistered charity" is an entity that has been removed from the Charities Register by the Department of Internal Affairs – Charities Services (formerly the Charities Commission).

In general, an entity must be registered with the Charities Services in order to qualify for the income tax exemption for charities. Registered charities are also "donee organisations", which means that donors are entitled to tax relief on donations made to these entities.

### New rules

New rules have been enacted that aim at clarifying the tax law so that deregistered charities and their donors have a greater level of certainty as to their tax obligations, and to protect the integrity of the tax base by ensuring the tax concessions that apply to charities are well targeted and policy intentions are met. The new rules:

- clarify how the general tax rules (including the income tax, fringe benefit tax, and donations tax relief regimes) apply to deregistered charities,
- establish the opening values of assets or consideration for any financial arrangements held by a deregistered charity when it becomes a tax-paying entity,
- prescribe specific timing rules for the application of the taxing provisions, and
- outline new requirements for the treatment of the accumulated assets of deregistered charities.

The amendments are generally effective on 14 April 2014.

***Please contact your local BDO tax adviser if you have any questions about how the rules apply to you.***

# NEW RULES FOR LIMITED PARTNERSHIPS

New rules relating to limited partnerships came into force on 1 September 2014.

The Limited Partnerships Amendment Act requires all limited partnerships to have a general partner who lives in New Zealand or an enforcement country. This person can be held responsible if a partnership fails to comply with its obligations.

The amendments aim to prevent the misuse of New Zealand limited partnerships by overseas entities and enhance the powers of the Registrar of Companies to verify information and take stronger action if required.

They are the first in a suite of law changes to improve the transparency of New Zealand's company registration system and reduce the risk of New Zealand entities being used for money laundering, fraud, tax evasion and other criminal activity.

Further amendments (made to the Limited Partnership Regulations 2008):

- require on every application to register a limited partnership, the place of birth for every proposed partner who is an individual
- specify Australia as an enforcement country
- prescribe certain directorship information in relation to every individual who is a proposed general partner of a limited partnership and resides in an enforcement country and is the director of a company in that country,
- prescribe similar information in relation to every individual who is the director, partner, or general partner of a proposed general partner that is not an individual (ie a company, partnership, or unincorporated body), and
- specify that Australia is a prescribed country for the purpose of s 19A of the Act (which disqualifies certain persons who have been disqualified in a prescribed country, state, or territory from being involved in the management of an overseas limited partnership).

Further changes tightening the criteria for company registration will take effect when the Companies Amendment Act 2014 comes into force on 1 May 2015.

# IS IT TIME TO TRANSFER YOUR UK PENSION?

Hot on the heels of the changes to the tax treatment in New Zealand of funds received from foreign superannuation schemes which took effect on 1 April 2014, the UK has announced significant changes which will see public sector defined benefit schemes "locked-in" from April 2015 onwards.

As a consequence, New Zealanders who worked in the UK in the public sector (for example in the National Health Service, railways and education sectors) may lose the ability to transfer those funds to a NZ QROPS approved scheme. It is understood that the private sector defined benefit plans are under consultation and legislation may result in private sector schemes also being unable to be transferred to NZ.

As the transfer process has in the past taken up to six months to organize, people with entitlements should evaluate the benefits of transferring those funds to a NZ approved scheme sooner rather than later.

Note a portion of a lump sum transfer post 1 April 2014 may be taxed in NZ with the portion determined by how long the person has been resident in NZ and how they have treated their interest in the foreign superannuation scheme in their previous tax returns.

Also those who are transitional tax residents for NZ tax purposes and so enjoy a four year exemption for passive overseas income should start the evaluation process immediately irrespective of where they are in their four year exemption period.

Each person's circumstances will need to be assessed on a case-by-case basis, with the tax implications and the closing window of opportunity being only two of the factors to be evaluated. It is important to take appropriate advice from an approved financial adviser with experience on transferring UK pensions.

# ON SHAKY GROUND – SEISMIC STRENGTHENING

Building owners are required by law to ensure that their property meets local authority earthquake codes. Failure to do so can result in hefty fines. It is well canvassed that many commercial building owners (particularly in the Christchurch and Wellington regions) will be required to carry out earthquake strengthening on buildings classified as "earthquake prone".

The question arises as to whether the associated costs are deductible for income tax purposes. The Inland Revenue position, supported by case-law, is that costs associated with earthquake strengthening buildings are not deductible. This is on the basis:

- The costs are capital in nature as they improve the asset (so there is no immediate deduction); and,
- As depreciation deductions are not permitted for buildings, no deduction is available to be spread over time (note most buildings are not considered to depreciate for income tax purposes).

In light of the Christchurch earthquakes, and more recent events in Wellington and the upper South Island, the deductibility of earthquake strengthening expenditure continues to be topical for property owners (in particular), policy-makers, and tax practitioners alike.

There are plenty of arguments both for and against deductibility and a robust debate to clarify the position once and for all would be welcome. Some of the questions that will need to be considered include:

- Is a deduction fair?
- Does a deduction assist in maintaining symmetry in the tax system and is symmetry a desired outcome? Recent tax changes with respect to lease inducements were made due to a lack of symmetry, primarily to resolve the situation where lease inducement payments were often deductible to the payer but non-taxable to the recipient.
- Can New Zealand afford the deduction route?
- Can a deduction be made available over time? For example perhaps over a 10 year period? Care would need to be taken to ensure that otherwise non-deductible / non-depreciable costs are not re-characterised as earthquake strengthening, thereby obtaining a deduction where otherwise they would not non-deductible.

We continue to discuss these issues with tax policy officials. If you have any strong views on these issues please feel free to contact your local BDO tax expert who would welcome a discussion with you in this regard.

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