Winter 2014
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TAX TODAY

IMPORTANT TAX CHANGES TO EMPLOYEE ALLOWANCES

Previously announced changes intended to clarify the tax treatment of certain employer provided benefits to employees have finally become law following the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 receiving Royal Assent on 30 June 2014.

The changes apply to the provision of accommodation benefits or allowances, certain reimbursing payments, work-related meals and work clothing.

The changes are intended to provide certainty over the tax treatment of the allowances and in some cases achieve this with rigid time thresholds which employers will need to manage carefully.

Employers who provide accommodation benefits/allowances and/or other types of allowances to reimburse their employees for certain expenses should:

- Carefully review the new rules;
- Assess the impact on existing employee benefits or allowances; and
- Amend the terms of the allowances where necessary.

As a result of the changes some allowances which an employer may have previously treated as exempt may become taxable; and others which an employer may have thought taxable may be exempt.

The changes could also impact on the employees who are entitled to income tested credits/allowances such as working for families tax credits. This could be particularly significant if an allowance previously treated as exempt becomes taxable.

The finalised legislation contains important amendments which are different from the original proposals set out in the IRD's officials issues paper released in November 2012, the Commissioner's subsequent statement of December 2012 or the Bill's first reading in November 2013. Accordingly care is required in assessing the impact as the final legislation may not achieve the tax treatment you were expecting. It is pleasing that some of the submissions made during the consultative process have been accepted into the final legislation.

Here is a summary of the main changes:

- Accommodation provided in situations involving shift work or remote workplaces are not subject to tax. Specifically, the exceptions cover mobile workplaces such as ships, trucks, or oil rigs; a station in Antarctica; accommodation provided for shift workers such as fire-fighters, ambulance staff, and care-givers; and accommodation provided at remote locations outside NZ when the person is required to work at the location for a period and then be absent from the location for a

Continued on next page.

IN THIS ISSUE

period (e.g. employees working at remote mines in Australia).

- When an employee is expected to work away from their normal workplace for up to two years, employer-provided accommodation is tax-exempt. This exemption extends to three years for employees working on capital projects and up to five years for Canterbury earthquake recovery projects. A more restrictive approach is taken for new employees (as opposed to existing employees) under the two-year rule compared with the three-year rule. However, the existing rules which can apply to relocation payments will continue to be relevant for new employees. For the two-year and three-year rules, there is a restricted ability to extend these time limits in exceptional circumstances (i.e. outside the control of the employer and employee).
- Accommodation or accommodation payments for those working at more than one workplace on an on-going basis, with one or more of those workplaces being a "distant workplace", is tax exempt without a maximum time limit.
- When an accommodation benefit is taxable, it is generally valued at its market rental value, unless a specific valuation rule says otherwise.
- There is a specific valuation rule for ministers of religion, to reflect longstanding administrative practice.
- There is a specific valuation rule for accommodation provided by the NZ Defence Forces to a number of its personnel, in recognition of the unique nature of their accommodation arrangements.
- Meal payments linked to work-related travel is exempt for up to three months. Meal payments and light refreshments outside of work-related travel (such as conferences) will also be tax-exempt.
- There is a specific exemption for payments for distinctive work clothing, to match the outcome where clothing is provided directly by the employer. Plain clothes allowances are exempt if paid to employees who are provided with a uniform but because of the nature of their current duties are required not to wear that uniform. However, there are special conditions attached to this exemption, including that the allowance was in place on 1 July 2013.

Effective Date

Most of the changes apply from 1 April 2015.

However, there is a choice of applying the revised rules to accommodation arrangements put in place on or after 1 January 2011, and to work-related meals from 1 April 2011 onwards, subject to meeting certain conditions.

These "transitional" rules are designed to protect a taxpayer if they have treated payments as being tax-free in the past, but within limitations they may also be applied where an employer has treated the payments as being taxable.

A special report issued by IRD on the changes indicates that the new rules may be backdated in limited circumstances and on an employee-by-employee basis to produce a refund to the employee where the employer has previously treated an allowance that would be exempt as taxable.

The changes specific to Canterbury earthquake recovery work apply from 4 September 2010, the date of the first earthquake.

Minister of Religion

The definition of "minister of religion" is quite wide: a person who is ordained, commissioned, appointed, or otherwise holds an office or position, regardless of their title or designation, as a minister of a religious denomination or community that meets the charitable purpose of the advancement of religion. The definition is not limited to Christian religions, but does not include administrators and other staff.

The taxable value of accommodation is capped at 10% of the minister's remuneration, subject to the accommodation being appropriate for the minister's position and ministry location.

There are then two adjustments which would be made if relevant.

- The first adjustment is in relation to the use of the accommodation for "work purposes". Although past administrative practice sometimes allowed a 15% adjustment, the new rule does not include any set percentage. Rather, it refers to the scenario where the person to whom the accommodation is provided uses part of the accommodation wholly or mainly for work purposes related to their duties as a minister. The apportionment would be based on the actual use for work purposes.
- The second adjustment would be required if two or more ministers share the accommodation.

Anti-Avoidance Provisions

These new rules are subject to certain conditions which aim to lessen the risk of abuse. Specifically:

- Accommodation cannot be tax-free if it is provided as part of a salary trade-off arrangement; and
- Time limits cannot be "reset" by arranging for the temporary cessation of employment or service.

This latter provision is particularly important to new transfers where the two or three year time limits apply and employers will need to be clear around how long an employee is expected to be away on contract and be provided the accommodation benefit or allowance.

More Information

The IRD's special report on the changes, can be found at: http://taxpolicy.ird.govt.nz/publications/2014-sr-employee-allowances/overview.

- Please contact your usual BDO tax adviser if you have any questions on how the new rules will affect accommodation benefits/allowances or other types of allowances paid to employees.

PAYING THE IRD ON TIME

A recent draft standard practice statement proposed several changes to the IRD's policy concerning when tax payments are treated as being on time. The proposed changes are:

- Payments (which includes cheques) mailed to the IRD will need to be received by the IRD on or before the due date. The current policy of allowing the payment to be mailed and post-marked on the due date will therefore end. The proposed change to a 3-day postal service will therefore need to be taken into account by taxpayers when making payment by cheque.
- Electronic payments will need to be paid into the IRD account on or before the due date.
- If the due date falls on a weekend or a public holiday, the payment will be treated as received on time if the payment is received on or before the next working day. However, a provincial anniversary day will not be treated as a public holiday; in other words, it will be a working day.
- Branches of Westpac will no longer accept cheques from 1 October 2014. However, cash and eftpos payments can still be made from 1 October 2014.

The IRD intends to implement these proposed changes from 1 October 2014.

Regarding provincial anniversary days, it is worth noting that the current Legislation Amendment Bill is intended to tidy up interpretation and definition issues. One of the proposed changes in this Bill is that the definition of "working day" will clearly exclude provincial anniversary days. The IRD will have to modify its proposed policy accordingly.

- For more information please contact your local BDO Tax Adviser

LAND ACQUISITION DATE

The date on which land is acquired is critically important to aspects of the land provisions contained with the Income Tax Act 2007 which tax gains derived from the sale of land within the concept of income. In particular the date of acquisition is important for determining:

- Whether a person had an intention or purpose of selling land at the time the land was acquired.
- Whether a person is associated with a developer, dealer in land or a builder at the time the land is acquired; and
- From what date various "10-year" rules commence.

It has not always been clear on which date land was deemed to be acquired for tax purposes and differing views existed. For example was it the date when an agreement for sale and purchase is entered into or the date when such an agreement becomes unconditional?

"First Interest Principle"

A recent legislative amendment sets the acquisition date as the date when a person first acquires an equitable or legal interest in, or option on, the land (the "first interest" principle).

This will usually be when a person first acquires an interest under an agreement for sale and purchase of land. The new rule has retrospective effect as it applies to all disposals of land occurring on or after 22 November 2013 (the date on which the tax bill was introduced to Parliament).

There are, however, some exceptions to the "first interest" rule, and therefore we strongly recommend you seek advice each time a land transaction is being contemplated to determine if the transaction falls within the scope of the land provisions.

The IRD continue to receive significant funding to pursue tax on land transactions and while it is beneficial to have certainty over the date of acquisition there may be possible issues with the implementation date.

- Talk to your usual BDO adviser if you have any questions about the new rule.

ADJUSTMENTS FOR TRADING STOCK TAKEN FOR OWN USE

A recent "Question we've been asked" publication from the IRD addressed the income tax implications when a sole trader, or a partner in a partnership, takes trading stock (including raw materials) for their own use or consumption. The IRD's conclusion was that the taxpayer needs to account for the trading stock at its market value. For example, if a livestock farmer takes an animal for private consumption, they would need to account for the animal as if it has been sold at its market value.

- For more information please contact your local BDO Tax Adviser

SCENARIOS ON TAX AVOIDANCE – EXAMPLES PROVIDED BY IRD

The IRD recently released a draft "Questions we've been asked" dealing with whether four particular scenarios could involve tax avoidance. The four scenarios covered are:

Scenario 1

A company is wholly-owned by one shareholder. The shareholder has advanced funds to the company which it uses to finance its business. The company borrows from a third party lender at arm's length interest rates and uses the borrowings to repay the shareholder loan. The shareholder uses the loan repayment to acquire a private asset. The IRD's conclusion is that this scenario is not a tax avoidance arrangement.

Scenario 2(a)

An existing company elects to become a "look-through company" (LTC), makes the required one-off payment of tax on the company's reserves at the company tax rate of 28% on entry into the LTC regime, and then makes a tax-free distribution of its reserves (i.e. after the company becomes an LTC). The IRD's conclusion is that this scenario is probably not a tax avoidance arrangement.

Scenario 2(b)

This is similar to Scenario 2(a), but at the time of making the LTC election, the company's directors had already decided to the sell the company's business and to liquidate the company after it joins the LTC regime. The IRD's conclusion is that this scenario could be viewed as a tax avoidance arrangement.

Scenario 3

A company converts shareholder debt in an arrangement which would not affect the proportionate interests of the shareholders, and with the result that there would be no effective change in the ownership of the company. The IRD's conclusion is that the convertibility feature of the debt could possibly be seen as artificial and contrived, and designed to circumvent the "substituting debenture rule", and therefore could be viewed as a tax avoidance arrangement. This rule is being repealed from 1 April 2015 and so this scenario should have limited application in the future.

Scenario 4

An insolvent qualifying company (QC) has loan which is owed to a shareholder, but the company is unable to repay the loan. If the shareholder writes off the loan, or if the company is wound-up, the company could derive "remission income" under the financial arrangements rules. Because the company is a QC, the shareholder would be personally liable for any tax due on the remission income. The company agrees to pay the shareholder an amount to repay all of part of the loan, and the shareholder will subscribe for new shares issued in the company, with the two amounts offset against each other so that no cash changes hands.

The IRD's conclusion is that the shareholder will not receive the loan repayment in commercial and economic terms. The company's financial position was such that the shares in the company would hold little value, regardless of the method adopted to value them. The shareholder will not receive a "gain" in value from the receipt of the shares commensurate with the face value of the loan ascribed to them by the parties. The IRD's view is that there is an element of artificiality and contrivance in this aspect of the arrangement, and that there will also be no dilution of the shareholder's interest in the company. In reality, the loan has been repaid only through the mechanism of the shareholder effectively providing the funds themselves by subscribing to shares that are all but valueless in their hands. Although the IRD recognises that there can be valid arrangements involving the capitalisation of debts, their

Continued on next page.

conclusion is that this particular scenario probably amounts to being a tax avoidance arrangement.

What this means to you?

The four scenarios are common commercial reorganisations which were put to the IRD at the NZICA 2013 Tax Conference. It is pleasing the IRD took up the challenge of providing their view on how the GAAR (General Anti-Avoidance Rule) might apply to those specific examples. However although illustrative examples help taxpayers and their advisers' better understand the IRD's view of the scope and breadth of the GAAR, this response to the draft QWBA raise many questions which need to be addressed.

It is hoped the submission process will help address those questions to ensure legitimate commercial reorganisations are not unnecessarily jeopardised by fear over the application of the GAAR.

▶ For more information please contact your local BDO Tax Adviser

FIF DEEMED RATE OF RETURN SET FOR 2013–14

Revenue Minister Todd McClay has announced that the deemed rate of return for taxing foreign investment fund (FIF) interests has been set at 7.99% for the 2013–14 income year, up from 6.91% for the previous income year. The deemed rate is set annually and is one of the methods that can be used to calculate income from FIF interests.

The rate is based on an average of the five-year Government bond interest rate at the end of each quarter, plus a 4% margin.

The Fair Dividend Rate Method which takes 5% of the market value of FIF's at the start of the year; and the Comparative Value Methods which captures the movement in the market value of the FIFs are likely to remain the more commonly used methods for calculating FIF income.

▶ For more information please contact your local BDO Tax Adviser

TAX POOLING TO BECOME MORE TAXPAYER FRIENDLY

On 3 July 2014, the Minister of Revenue announced proposed changes to the tax pooling rules to make the tax pooling rules more effective.

Tax pooling allows taxpayers who have underpaid their provisional tax to benefit from a transfer from a taxpayer who has overpaid their provisional tax through a tax pool run by authorised intermediaries.

The Minister of Revenue is to introduce legislation which will allow taxpayers to use tax pooling arrangements to pay any interest owed as a result of a tax dispute or an amended tax assessment.

The current rules allow taxpayers to withdraw funds from a tax pool to cover the tax owed but not any interest that might be due. This can result in further interest accruing on the remaining amount which was not the original intention of the legislation.

The amendments will greatly benefit taxpayers with back-year audits, and those involved in long-running disputes with IRD. It will allow taxpayers to better manage their exposure to use of money interest (UOMI) charges.

From 3 July 2014, taxpayers will be able to use tax pool funds to meet UOMI and core tax obligations. The legislation is to be effective from 3 July 2014 and will be introduced in the next available tax bill.

▶ For more information please contact your local BDO Tax Adviser

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