Harvie Green Wyatt
CHARTERED ACCOUNTANTS

Newsletter

AUTUMN 2024

Tax changes loom for residential rental income

Changes are coming for tax on residential rental income.

Interest Deductibility

For the year ending 31 March 2024 the interest deduction allowed for those who owned properties on 27 March 2021 is reduced to 50%. However, draft legislation has been recently released to phase back the ability to claim interest deductions for residential properties.

As proposed, 80% of interest paid from 1 April 2024 to 31 March 2025 will be deductible and this increases to 100% for interest paid from 1 April 2025.

Until the ability to claim interest deductions is fully phased in, the current exemption from the interest limitation rules continue to apply. These cover land that is used as a business premises, build-to-rent land, land used for social, emergency, council or transitional housing and land held by property developers.

Where gains on the sale of a property are ultimately subject to tax under any land taxing rules, any interest for which a deduction has been denied can continue to be added to the cost of the property.

Building Depreciation

The depreciation deduction, which is allowed on commercial buildings but not residential, is going to be withdrawn from the 2024-2025 year onwards.

It is also proposed that the definition of a building is to exclude commercial fit out which can continue to be depreciated separately.

In addition, the previous rule allowing for a deemed fit out % is to be reintroduced for buildings acquired on or before 2010-2011 income year and which have not recorded commercial fit out separately.

Bright-line

Currently residential property sold within 10 years (in some cases 5 years) of purchase may be subject to the Bright-Line Test. This means any profit made forms part of taxable income.

Draft legislation confirms that the bright-line period is to be reduced to 2 years. This will apply to disposals of residential land where the bright-line end date occurs on or after 1 July 2024.

The main home exclusion will apply if the property has been used predominately, for most of the time the person owned the land, for a dwelling that was the persons main home.

Reminder: The profit made on property bought with the intention of selling for a profit is still taxable income and always has been.

Purchasing a rental property for the purpose of ongoing rental income, with the knowledge you will get a capital gain in the long run, is not considered purchase with the intention of selling for a profit. We all know property goes up in value over time.

CRM now for small businesses

CRM – or customer relationship management – software has largely been used only by large companies as a powerful sales efficiency tool.

But now CRM software is more cost-effective and easy to use for small businesses.

A CRM can help to improve service and sell more to existing customers, automate marketing and sales processes, better track and manage business performance, improve team communication and provide real-time information on mobile devices to your sales team.

One of the big benefits is in helping salespeople to provide quotes to potential customers more quickly. Many businesses miss out on sales because their quote is sent too late.

CRM software is mostly cloud-based, and solutions can be as complex or as simple as your business needs. Some of it is low cost or free, so search online for what suits you.

Xero Tips & Tricks

It's been a couple of years since the bulk of our clients made the transition to Xero so we are running a session to go over some helpful tools and shortcuts now that you'll be familiar with the basics. There will also be time to ask specific questions relating to your Xero file.

There will be no cost to attend.

We are looking at the week of the 8th of April 2024 with groups of 6 – 8 clients and will be running commercial specific and farming specific sessions in both Dunedin and Oamaru.

If you are interested please email xero@hgw.co.nz by 5th April 2024 to book your spot.

Prepayments and insurance

A prepayment is the portion of an expense relating to the following tax year.

For example, rent of premises is usually paid in advance. This would mean if your lease requires you to pay the rent on the 20th of each month and you have a March balance date, your 20 March payment would include rent for 1 April to 19 April, which falls in the next financial year. This latter portion of the rent does not relate to deriving income to 31 March so logically it should not be claimable.

Inland Revenue recognises it would give everybody a lot of work if they had to adjust for all prepaid expenses like these no matter how small the amount or what length of time the prepayment relates to. Determination E12 provides some relief here. This sets out the prepaid expenses for which you do not need to adjust for tax purposes, provided you do not treat them as prepayments in your financial statements. For leases, you don't have to adjust where the prepaid portion is no more than one month.

Another of these expenses is insurance. The amount in the Determination is $12,000 of premium for any contract. So if your premium is less than $12,000 and you have paid it before the end of the financial year, you don't have to adjust for the prepaid portion. Premiums have risen in recent years, so you might find you're now paying more than this. If so, you should adjust the expense claim, effectively taking the prepaid portion as a deduction into the next year. You would need to tell us about this. Note Inland Revenue requires the adjustment for each contract as opposed to each policy.

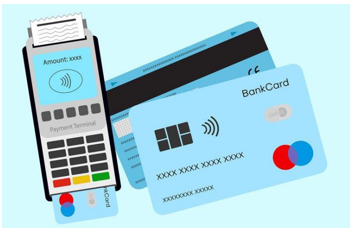
Contactless shopping on the rise as retailers embrace technology

One of the tech trends predicted for 2024 is a big acceleration in the adoption of contactless shopping.

Large retailers trying to cut costs and boost profitability are increasingly moving to mobile and social media shopping. Small businesses aren't far behind as they're finding prices for the necessary technologies are becoming more manageable.

Retailers are looking at greater use of QR codes, mobile terminals and mobile wallets, which are becoming more prevalent as shoppers use them more often to shop and pay. These technologies can be lifesavers for small businesses with limited staff.

It's likely more owners of hospitality venues will throughout this year be introducing touch



screen or app customer ordering systems. These "tap and pay" systems can reduce queues and ensure payment before delivery.

The clinical approach to customer service, however, creates challenges for retailers who still value person-to-person interaction. Hybrid operations that incorporate technology and the human factor are more likely, but there will be opportunities for retailers who emphasise personal service.

BRIEFS

GST registration for part-time business

You do not have the right to continue to be registered for GST if your business is not being carried on continuously or regularly. Sometimes clients either take a salaried job, operating their business part-time, or drift into semi-retirement. They need to look at the amount of work they do to see whether they still comply with the "continuously or regularly" criteria. If they don't, they need to deregister for GST and pay GST on the market value of any assets they retain.

Loans to your company

If you borrow money for your company, you should make sure it is the company that signs up for the loan. If the money is lent to you and just put in the company, then the interest is not tax deductible. It is possible to get around the problem, but to do so adds to your costs. There's also the risk of Inland Revenue not agreeing with what you might do.

No FBT under scheme

Inland Revenue has approved a scheme as not being subject to Fringe Benefit Tax (FBT). WorkRide Ltd provides self-powered commuting vehicles to the employees of its customers. The employees agree to a temporary reduction in salary in return for the temporary lease of equipment, and the opportunity at the end of the lease to own it. IRD has approved the scheme starting 1 December 2023 and ending on 30 November 2026

Assessing your business's viability

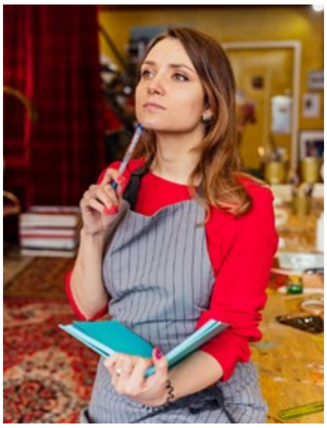
Sitting back at your desk after a month of busy family time or relaxing beach days, business owners and executive teams should start to think about not only the year ahead, but the long-term viability of their businesses.

With rapid changes and multiple existential threats impacting different businesses in different ways, it might be an opportunistic time to ask yourself: do you expect your market and/or customers to be subject to fundamental change? Will your business be viable in ten years' time if it continues on its current trajectory? Do you have the option of carrying on as you are and hoping for the best, or do you need to make some proactive (and potentially risky) changes to give your business the best chance of continuing into the future?

With pressure from consumers for reinvention intensifying, it's no surprise that we are seeing businesses adopting new technology. Air New Zealand, aware of its reliance on fossil fuels, is looking at new ways to power their aircraft fleet. They have just purchased their first all-electric aircraft which will operate cargo routes starting in 2026. They also plan to begin replacing their regional domestic fleet with more sustainable aircraft, with goals to use either green hydrogen or battery hybrid systems from 2030.

Other companies are pivoting into new areas to meet changing consumer demands. For example, consider the amount of 'plant-based alternatives' available today, with fast food restaurants like Burger King offering an entire range of plant-based meat.

It's no secret that climate change and sustainability are hot topics at the moment, and while much of the change is driven by Government, the reality is that consumers are forcing these changes with their wallet.



It is becoming more and more common for a business to accept a lower return on climate-friendly investments, showing a willingness to accept a trade-off of financial return for sustainability outcomes.

Electric vehicle sales are rising across the country, and while it might not have been a consideration 20 years ago, consumers now consider whether the products they purchase have been ethically and sustainably produced.

Companies even need to be mindful of sustainability if they want access to capital, with banks, investors and equity funds refusing to invest or adopting a sinking lid approach depending on the industry a company operates in.

The changes happening now are not just something that the big companies need to worry about. Small companies are more likely than their larger company counterparts to feel their company's viability threatened, and for good reason. The shifts over the coming decades will have flow on effects to all facets of business. Think electric cars – what is a mechanic doing 20 years from now, or a petrol station operator, or the person that leases the land to the petrol station?

By taking the time to reflect, you place yourself in a much better position to not only survive the next few decades but also capitalise.

End of year write-offs

As increasing interest rates have bitten and with industry sectors such as retail and construction not performing as strongly, some businesses are struggling. As the end of the financial year approaches, now is a good time to assess whether any of your accounts receivable need to be written off as 'bad'. This is because, in order to claim a tax deduction, a bad debt needs to be physically written off as bad within the income year.

Whether an amount is "bad" was discussed by Inland Revenue in Public Ruling BR Pub 18/07. The factors to be considered include:

- the time period the debt has been outstanding;
- steps taken by the lender to recover/collect the debt;
- knowledge of the debtor's financial position;
- status of the debtor, e.g. deceased, unreachable, or in receivership or liquidation; and
- when the debt will become statute barred.

Inland Revenue noted that it is not necessary for a debtor to be insolvent or that legal proceedings be commenced to recover a debt, in order for it to be 'bad'.

Evidence of what recovery action has been taken and why the debt is considered bad should be held in the event of review by Inland Revenue.

If GST has been paid on a sale that has subsequently been written off as bad, the GST paid on the sale should also be recoverable from Inland Revenue.

Paying tax on a sale for which you will not be paid is like pouring salt into a wound, and to be avoided where possible.

Beware of deemed dividends

The concept of what is a "dividend" is very broad and starts with the default proposition that any transfer of value from a company to a shareholder is a dividend. That concept includes the simple scenario of an interest free loan to a shareholder or a person associated to a shareholder, which can also include loans between companies.
This matters because a dividend is taxable to the recipient, but not deductible to the payer, i.e. it gives rise to a net tax cost. The standard solution to eliminate the dividend is to charge interest on the loan at either a market rate or the prescribed FBT rate (depending on the parties to the loan).
But not all interest free loans made by a company will give rise to a deemed dividend, some do, some don't and this is an area where mistakes are often made resulting in either no interest being charged when required, or interest being charged when it is not required.
When determining whether loans between related companies can be interest-free or not, two key sections of the Act should be considered – sections CD 27 and CW 10.
If section CD 27 applies, a transfer of value is specifically excluded from being a dividend and then can be ignored for this purpose. The section applies to 'downstream' dividends, e.g. a loan from a parent company to a subsidiary. The provision itself is complex and needs to be worked through on a case by case basis, but it is helpful.
If the exemptions in section CD 27 do not apply and a dividend has arisen, then section CW 10 may help. The section is a broader provision that deems a dividend between wholly owned companies (i.e. companies that have identical shareholders) to be exempt income of the recipient.
This is an area Inland Revenue has and will continue to scrutinize, as seen in a recent Technical Decision Summary (TDS), TDS 24/01.
The TDS concerned an interest-free loan made from a parent company (Company C) to a subsidiary (Company A) and whether the interest-free loan gave rise to a dividend to Company C (yes, the lender).
Importantly, the Tax Counsel Office (TCO) initially points out that Company A is the recipient of the value (being the interest-free loan), hence no dividend has arisen to Company C. The TCO then concluded that the exclusion under section CD 27 applied such that the interest-free loan did not give rise to a dividend.
The TDS also commented on whether the arrangement comprised 'tax avoidance' and stated that it did not raise any tax avoidance concerns because the legislation was working as intended because the Act contemplated capital could be provided by way of interest free loan.
Reading between the lines, it appears an over eager person at Inland Revenue was trying to find something that wasn't there.
As an aside, trusts legally do not pay dividends, hence the deemed dividend risk and therefore the need to charge interest (from a tax perspective) should not apply to a trust.

TAX CALENDAR

7 April 2024

Terminal tax for 2023 (March, April, May balance dates). For all clients except those who have lost their extension of time privilege.

7 May 2024

Third instalment of 2024 Provisional Tax (March balance date)

28 May 2024

First instalment 2025 Provisional Tax (December balance date)

31 May 2024

Deadline for Fringe Benefits Tax returns.

Family trusts and children who grow up

The maximum amount you can distribute from a family trust to a child who is under the age of 16 on the trust balance date is $1000 to still have this taxed at the child's personal tax rate.
If you distribute just one dollar more, the tax rate becomes the same as for the trust.
It's easy for us, with our busy business lives, to not notice when a child goes over the age of 16. Instead of paying 39% tax on the trust income, it could be handy to allocate some of its income to the youngster, perhaps to help with tertiary education. Once the age of 16 has been reached, the amount you can allocate to a young person is no longer limited.

Online platform GST looks to stay

The new government appears not to be removing the GST charges to be made by online platforms (companies finding customers for you through their website).

From 1 April 2024, online platforms that offer the following services will charge your customers GST:

- Ride sharing and ride hailing
- Food and beverage delivery, such as Uber Eats
- Short stay and visitor accommodation.

If not registered for GST

If the government received all the GST, this would be unfair because there is GST in the expenses incurred in providing the services – for example, rates and insurance paid on short-term accommodation. As a consequence, some of the GST will be paid to you to compensate you for the GST claim you are missing out on, and some to the Inland Revenue.

The online platform will pay you an extra 8.5% and it will pay the balance of the GST, being 6.5%, to Inland Revenue. Obviously this is going to increase the price of the services, which might put some pressure on the amount you charge.

If registered for GST

The platform will pay all the GST to Inland Revenue. As a consequence, you will treat your income from the online platform as zero-rated income. You will claim GST in the usual way.

See further detail on this on the next page in our newsletter.

Gains on fixed interest investments

Sometimes you can buy an investment at either a premium or discount.

For example, you decide to buy $20,000 worth of XYZ bonds because you think they're paying a good interest rate and you are comfortable the company will be around to pay back. This means XYZ Ltd will pay you at some stated date $20,000 and in the meantime they will pay you interest.

What happens if you buy the bond from somebody, perhaps a sharebroker, for $19,750? You have bought at a discount of $250.

Inland Revenue says when you get this money back you have to also account for the $250. You have made a profit of this amount and you have to treat it as taxable income. They would also agree if you had paid $20,250, you could claim back, as an expense, the extra $250 you paid.

What they do in practice is to add up all the money you have ever received from the investment and deduct all the money it has cost you – the difference is taxable income. This is because some of these arrangements are more complicated than described above. Inland Revenue calls this process making a "base price adjustment".

You should also note that bigger investors, particularly those with fixed interest-type investments exceeding $1 million, are expected to spread the premium or discount over the term of the investment. This means that if, for example, you bought your investment on 1 February 2024 and it was going to mature on 1August 2026, you would be investing for 30 months.

The correct way to apportion the premium or discount is to take the total number of days and apportion over each financial year. For the year ending 31 March 2024 this would be 60 days in this example.

Deal with important stuff now, before balance date

You need to think about the following before your balance date, which is 31 March for most businesses.

Stock

Cull your stock. If some of it is only fit for the tip then get rid of it. If it is still on your premises, it has to be included.

Remember, stock has to be valued at its cost, including the cost of getting it into your shop, warehouse etc. You may use market value, if it is lower than cost, instead of cost for an item, but you will need to keep evidence to show where you could have bought the item at the lower price.

Motor vehicle

If you are going to make a claim for use of your vehicle for business on a kilometre rate basis, remember to read your odometer at the end of the day on balance date.

Insurance premiums

If you get to the end of the financial year and you're paying off an insurance policy, make sure you have an agreed arrangement for payment with the insurance company. If you haven't and the insurance company would have a right to cancel your policy for unpaid premiums (even though it would be unlikely to do so), you might not be entitled to bring the whole of the unpaid portion into account as a sundry creditor (also known as Accounts Payable).

Vehicle logbook

If you need to keep a vehicle logbook, this needs to be for a continuous typical three months of vehicle running. A new recording needs to be made once every three years (or more often if there is a major change

New Digital Marketplace rules—what hosts and drivers need to know

If you provide food delivery, ride-sharing or short-stay accommodation services, you need to know about changes to the GST treatment of these services that apply for bookings made from 1 April 2024.

What's happening?

In most cases, the supplier of a service for GST purposes is the person who actually performs the service, regardless of how the service is paid for.

From 1 April 2024, a new law will apply to deem electronic platforms to be the supplier of certain services. This means the person providing the service won't be required to account for GST on those services, whether or not they meet the threshold.

Instead, the platform operator will return GST on the supplies as though they had provided them directly. The person actually providing the service (the "underlying supplier") is treated as making a zero-rated supply (a supply taxed at 0% instead of 15%) to the platform operator.

The services affected are:

- ride-sharing and ride-hailing[1]
- delivery services for beverages, food, or both, and[2]
- taxable accommodation[3]

Services provided or received outside NZ are not included, however services that are "closely connected" to a listed service (e.g. an AirBnB cleaning fee) are caught.

What's an electronic marketplace?

Any website or app which makes a supply of a listed service through another person (the underlying supplier) to a third person. This doesn't include an entity that solely processes payments.

It also doesn't include platforms that merely connect buyers and sellers, but otherwise do not participate in the transaction by imposing terms and conditions or mediating in disputes. Generally speaking this means a platform like TradeMe or Facebook Marketplace would not be included.

How am I affected?

If you are GST-registered, nothing changes regarding your input tax deductions – you claim these as normal. However, when you take a booking through an electronic marketplace, you now return this as a zero-rated sale. You return output tax as normal on supplies not made through an electronic marketplace.

If you are not GST-registered, you are still not required to file GST returns. What will happen instead is that you will receive a "flat-rate credit" from the platform operator to compensate you for the input tax credits you could have claimed if you were registered. This rate is set initially at 8.5% of the value of the sale. The platform operator is required to report to you regularly regarding the amount of credit they have paid you.

What about direct sales?

If you make sales through other channels such as your own website, this is not an "electronic marketplace" under the rules. Nothing changes for these transactions. This means you may need to have a process for tracking how bookings were made (note it doesn't matter if the payment is made directly to you or via a platform operator – the booking determines the treatment). You may also need to reconsider the benefit of listing on a platform.

Can I opt out?

You can opt out of the flat-rate credit scheme simply by registering for GST.

Opting out of the rules entirely is only available to someone who lists at least 2,000 room nights per year of accommodation on a single platform. It is not available to other listed services.

If you meet the requirements and wish to opt out, you need to inform the platform operator before 1 April 2024. After that date, you need the platform operator's agreement.

How does this affect my accounts?

If you are not registered for GST, you will need a new account code to account for the flat-rate credit. Nothing else will change.

If you are registered for GST, you will need to change the account code for platform-based sales to be zero-rated, unless you opt out (see above). If you take bookings directly and through a platform, you will need two account codes to track which sales are caught by the rules and which are not.

You will need to ensure listed services provided through a platform are returned in your GST returns as zero-rated.

Example – non-registered supplier

Henry provides short-term accommodation through an electronic marketplace to Josie for $200 plus GST. The marketplace operator collects GST of $30 on the supply of accommodation they are treated as making to Josie.

The marketplace operator calculates the flat-rate credit as follows:

- GST of $30 at 15% of the value of the supply of the accommodation, and
- the input tax deduction of $17 for the flat-rate credit at 8.5% of the value of the supply of the accommodation.

The marketplace operator is required to deduct input tax of $17 from the $30 of output tax payable to Inland Revenue. It is also required to pass on the $17 to Henry as a flat-rate credit.

The marketplace operator must also pay the remaining $13 to Inland Revenue as the net GST payable on the supply of accommodation.

Example – registered underlying supplier

Manjula provides ride-sharing/ride-hailing services through an electronic marketplace.

Manjula pays $3,450 including GST for goods and services such as fuel, vehicle maintenance, and insurance. Manjula includes these expenses in his GST return.

Manjula earns $2,500 from services through an electronic marketplace and $5,000 from other activities conducted off the electronic marketplace.

To complete his GST return, Manjula includes:

- $2,500 of sales in the "Zero-rated supplies" box
- $5,000 of sales in the "Total sales and income" box
- $3,450 of costs in the "Total purchases and expenses" box. He will then calculate input tax deductions of $450.

1. Does not include services operating on a fixed route or schedule such as a shuttle service
2. Only the delivery service, not the food or beverages themselves
3. Excludes exempt accommodation (long term rental) but includes accommodation charged at the hybrid rate (>4 weeks)

De facto relationship or not?

The Working for Families Tax Credit (WFFTC) is a notoriously complex scheme when it comes to determining eligibility and quantifying entitlement. This leads you to wonder how well the scheme is policed by Inland Revenue, and whether fraud is able to 'fly under the radar'.

Accordingly, it was heartening to see a case brought before the Taxation Review Authority in October of last year regarding a taxpayer making false claims about their de facto relationship.

The taxpayer claimed $39,740 of WFFTC's for the years 2015 to 2018 on the basis that they were a single parent. However, at the time they were living with a Mr X, with whom the Commissioner considered the taxpayer to be in a de facto relationship.

Support was given by the taxpayer, their sister, and Mr X claiming that no de facto relationship existed. However, the evidence to the contrary was extensive. They lived together, went on holidays together, had social media profiles that indicated they were a couple, attended work functions as a 'couple' and were financially interdependent. As a result, the income of Mr X was deemed to be included in the WFFTC calculation and the taxpayer's actual entitlement for the four years was reduced to nil.

If the taxpayer was not satisfied with this, the Commissioner went further to say that regardless of whether a de facto relationship existed or not, their entitlement would have been reduced anyway due to the taxpayer stealing from her place of employment. Because they had stolen money, it would count as income towards the calculation of their WFFTC and their entitlements should have been reduced in 2016 and 2018, and no entitlement would have existed in 2017.

The taxpayer claimed that the Commissioner should exercise their discretion to not collect tax given that the stolen money was used to fund their gambling addiction. Unsurprisingly, the Commissioner held that the taxpayer's circumstances were 'far from justifying the exercise of such a discretion'.

Although this case demonstrates some absurd circumstances, it provides comfort that Inland Revenue does apply resources to ensure schemes such as WFFTC are policed and that their exploitation is met with appropriate action. It also demonstrates the variety of investigation skills within Inland Revenue and provides a warning for those who are considering stretching the truth when it comes to their

Trust Disclosure regime – Insights from the first year

After the introduction of the Trust Disclosure rules in March 2022, in November 2023 Inland Revenue released a high-level summary (in the form of a 40-page report) of insights from the first year of reporting.

While tax advisors and clients alike may have begrudgingly completed the disclosures initially, the statistics may prove to be interesting.

The stated purpose of the trust disclosure rules was to provide insights into the way trusts are used, and to ensure compliance with the 39% individual tax rate. The information gathered included reporting on details of settlors, individuals with powers of appointment, beneficiaries, and various financial information.

A recurring theme throughout the report was the level of errors, but not surprising given the complexity of the disclosure rules and it being the first year. Of the 226,000 IR6s received, the errors included:

- 26,000 trusts that provided no financial information but had indicated that they were required to comply.
- An additional 16,000 trusts that only completed the IR10 but did not complete the financial information section of the IR6.
- 49,000 trusts that provided no settlor details.
- 450 instances of beneficiary distributions to minors that exceeded $1,000.
- 300 trust beneficiaries who owe student loans that failed to disclose their trust distributions.
- 1,400 Working for Families recipients that failed to disclose their trust distributions.
- 500 instances where income had been allocated to tax-exempt beneficiaries even though the distribution had not been paid.
- 3,500 trusts that retained trustee income despite having ceased in the same year.
- 250 instances of beneficiary income being allocated to offshore beneficiaries that had not been included in a NZ non-resident tax return.

Conversely, there were also numerous trusts that complied with the rules despite not being required to – including 35,000 trusts filing nil tax returns, of which 11,500 provided financial information.

Other key insights into trust income and assets included:

- Total trust assets amounting to $470 billion, which was up from $240 billion reported on the IR10 in 2016.
- $91 billion of trust assets comprising shares and $191 billion comprising land and buildings.
- 16,000 trusts reported untaxed realised gains of $14 billion. This compared to 5,000 trusts which reported $4 billion in untaxed realised gains in 2016.
- The amount of beneficiary income allocated to individuals earning over $180,000 dropping from $900 million in 2020 to $450 million in 2022.

As a result of the information gathered, the Government may consider policy reform to address some of the issues identified – such as implementing a two-month payment notification requirement for beneficiary distributions to charities, in line with Australia's regime. Greater scrutiny of Trust tax affairs is expected, especially as the Government has provided additional funding to complete audits and investigations.