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NEWSLETTER

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Modernising New Zealand's tax system

The Government has released two discussion papers to engage in public consultation on options for simplifying and modernising New Zealand's tax system. The documents introduce taxpayers to the general direction the Government intends to take to improve administration of the tax system.

Basically, the Government wants to simplify tax for individuals and businesses by reducing compliance costs, and making interactions with the IRD faster, more accurate and convenient with a greater use of electronic and online processes. As the IRD puts it, "tax obligations should be easy to comply with and hard to get wrong".

The first discussion paper 'Making tax simpler – A Government green paper on tax administration' outlines the overall direction of the tax administration modernisation programme. Key elements of potential change include:

- Simplifying tax for businesses, for example by streamlining the collection of PAYE, GST and other withholding taxes and integrating these obligations into business processes. Options will be investigated for simplifying the calculation of provisional tax – with more emphasis on real time information, together with payment options that better reflect taxpayer's cash flows.
- Simplifying tax for individuals by providing online income tax statements for individuals pre-populated with income details, so that all that would be required is to 'check and confirm'. Technology will be used more effectively to better manage both overpayments and underpayments of tax.

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- Social policy objectives would be met by using information that the IRD or the Government already holds, providing for timely payments on a more real-time basis, resulting in certainty for individuals and families. With faster, more accurate information, there should be less chance of people receiving too much and going into debt.

The IRD wants to make tax obligations part of the normal day-to-day business processes, making it quick, easy and harder to get things wrong.

Consultation closes on 29 May 2015.

The second discussion document 'Making tax simpler - Better digital services' outlines proposals for greater use of electronic and online processes. In particular the discussion document considers whether secure digital services can be delivered using the current policy and legislative framework and discusses options to move people to digital services, these include:

- The IRD working with third parties such as banks and business software developers so that tax interactions are built into a customer's regular transactions rather than managing tax separately at specific times of the year.
- Non-digital services will need to be provided for those who still cannot use digital services.
- A process would be developed for moving to a digital format those who could potentially use digital systems for some services - in circumstances where there would be wider benefits accrued.

Consultation closes on 15 May 2015.

These are the first two releases in a series of public consultations designed to modernise and simplify the tax system. Further discussion documents will be released over the next two years and public feedback is requested.

The significance of this process can't be overstated. In an age where changes in lifestyle as a result of technology have moved at an explosive rate, the design, administration and technology associated with our tax system have not kept up.

Holding a parent company liable for the debts of its subsidiary

A recent High Court decision, Lewis Holdings Ltd v Steel & Tube Holdings Ltd (2014), demonstrates that structuring a business or entering into new business ventures through separate companies to ring fence risk may not always be as effective as people think.

The case involved a property that had been leased by Lewis Holding Limited (Lewis) to Stube Industries Limited (Stube). Stube is a subsidiary of Steel & Tube Holding Limited (STH). In 2013, Stube was placed into liquidation and Lewis filed a claim against Stube for debts owed under the lease agreement. However, under a rarely utilised provision of the Companies Act, the liquidator sought an order requiring STH to pay Stube's debts. The provision looks at to what extent a company took part in the management of, and is responsible for the company being placed in liquidation.

The High Court decided in favour of Lewis, requiring STH to pay the full amount claimed by Lewis, i.e. a parent company was held liable for the debts of its subsidiary. The Court based its decision on the following key findings:

- The CEO and CFO of STH were directors of Stube and did not approach their duties as directors in a way that recognised Stube as a separate legal entity.
- The STH group of companies acted as a single unit. Stube was more akin to a division of that unit, for example, their financial affairs were intertwined and Stube had no separate bank account.
- STH treated the lease as their own and made lease payments to Lewis. This provided Lewis with the impression that Stube was not treated as a separate legal entity by STH.
- Stube had no employees, but used STH's employees to conduct business. This supply of services was not reflected in a written agreement, and no intercompany charge occurred.
- Stube did not obtain independent advice when entering major transactions.
- Stube's fate was sealed when STH stopped financially supporting it.

The decision flags the need to take a best practice approach when operating what is essentially a single business across multiple companies, which is extremely common in New Zealand.

The decision is to be appealed and the final outcome might change. But regardless of the outcome, it won't change the need to take a best practice approach.

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New Tax Bill

On 26 February 2015, the Government introduced the Taxation (Annual Rates for 2015 – 16, Research and Development, and Remedial Matters) Bill (the Bill). It is the first sizeable bill to introduce amendments to the tax rules since November 2013. The Bill contains changes intended to address tax impediments to research and development (R&D) and innovation, and to clarify goods and services tax (GST) rules for body corporates.

This article provides a brief summary of the key changes proposed by the Bill.

R&D tax losses
The Bill includes legislation to allow tax loss-making R&D companies to "cash out" their tax losses from R&D expenditure. The main eligibility requirements are that the company must be a loss-making company resident in New Zealand, with a sufficient proportion of expenditure on R&D. Companies that qualify will be able to receive 28% (the current company tax rate) of their qualifying expenditure as a cash refund from IRD, capped at $140,000 for the 2015 – 16 year. The threshold increases by $84,000 per year, over the next five years to $560,000.

Black hole expenditure and intangible assets
The Bill amends the rules relating to "black hole expenditure" (business expenditure that is not immediately deductible for income tax purposes and cannot be deducted over time as depreciation). The proposals are targeted primarily at black hole R&D expenditure.

There are a number of anomalies under the current rules which are to be fixed. Intangible assets are generally able to be amortised if they have a defined useful life (such as a patent). If costs are incurred to develop an asset with no defined life (such as a trademark) and that asset is written off, no tax deduction is available. In this situation a tax deduction is to be allowed.

Also, there is some uncertainty around what costs can be included when amortising intangible assets, e.g. a patent versus the underlying knowledge covered by the patent. The rules will be amended to extend an asset's "cost" to include the underlying item of depreciable intangible property.

The list of intangible property that is able to be amortised will be amended to include a design registration, a design registration application and a copyright in an artistic work that has been applied industrially.

GST and bodies corporate
There has been considerable uncertainty and media coverage in recent years regarding the GST position of bodies corporate. The Bill proposes to clarify the situation by amending the GST rules to reflect that a service provided by a body corporate to a member is a supply that is subject to GST. However, those supplies are excluded when determining whether the total value of the supplies made by a body corporate exceeds the compulsory GST registration threshold. This effectively gives bodies corporate the option of registering for GST. There are a number of rules being introduced to ensure the rules aren't 'gamed' or taken advantage of – these should be examined in detail before a position is taken.

Health & Safety reform

Each year on average, 75 people die on the job and 1 in 10 people are injured at work. With statistics this high, it's not surprising the Government is reforming New Zealand's health and safety landscape.

A new Health and Safety Reform Bill (the Bill) is currently before Parliament and is expected to pass later this year. The Bill will create the new Health and Safety at Work Act, replacing the Health and Safety in Employment Act 1992 and aims to reduce workplace injury and death tolls by 25 per cent by 2020. The Bill introduces changes to the allocation of health and safety duties in the workplace and increases the compliance and enforcement tools available to inspectors.

Under the current legislation, there is a primary focus on the employer and employee roles and duties are carefully placed on defined participants (such as employers, principals, the self-employed etc).

The new Bill introduces the concept of a 'Person Conducting a Business or Undertaking' (PCBU), which replaces the previous duty holders. The PCBU will be allocated primary duties of care with

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regards to health and safety at work where they are in the best position to control risks to work health and safety.

The primary duty of care requires all PCBUs to ensure, so far as is reasonably practicable:

- the health and safety of workers employed or engaged or caused to be employed or engaged, by the PCBU or those workers who are influenced or directed by the PCBU (for example, workers and contractors), and
- that the health and safety of other people is not put at risk from work carried out as part of the conduct of the business or undertaking (for example visitors and customers).

This means that PCBUs will need to think broadly about who they affect through the conduct of their business or undertaking, rather than just direct employees or contractors. Where there are overlapping health and safety duties (such as multiple contractors on a building site), each PCBU has a duty to consult and co-operate with the other PCBUs to ensure health and safety matters are managed.

A new duty proposed under the Bill is that an 'officer' of a PCBU (such as a company director or partner), must exercise due diligence to ensure that the PCBU complies with its duties. This places a responsibility on people at the governance level of an organisation to actively engage in health and safety matters, reinforcing that health and safety is everyone's responsibility.

Workers also have specific health and safety duties at work and the Bill defines the duties they owe and are owed (for example, a duty to take reasonable care of their own health and safety). The Bill will also apply to volunteers in certain circumstances.

The Bill provides a wider range of enforcement tools for inspectors and for increased penalties for infringements. There will be three types of offences for a breach of a health and safety duty and a breach will be graded based on the conduct of the duty holders and the outcome of the breach. For example, a person may be jailed for up to five years if they have a health and safety duty and, without reasonable excuse, are reckless and engage in conduct that exposes a person to a risk of death or serious injury or illness. A body corporate in a similar position may be fined up to $3 million.

There will be several months between when the Bill is passed and when it comes into force to give people time to prepare for the new regime.

Spring clean

We have recently gone through the end of another financial year, and we now turn our minds to looking forward and where to from here. As part of this process, it is worthwhile looking at your business's structure and whether it needs a 'spring clean'. It is surprising how often companies are set up for specific purposes, but later when there is no longer a need for that company, nothing is done and it just hangs around.

There are basically three options to 'kill' a solvent New Zealand company:

- 'short-form removal' from the companies register,
- 'solvent liquidation', or
- do nothing, i.e. don't file the annual return with the Companies Office.

The third option is included for completeness, but it is not generally recommended. The first two are discussed below.

Short-form removal
A short-form removal request can be completed online at www.business.govt.nz/companies by providing:

- A shareholder or director resolution providing for the company to be written off because:
  - it has ceased trading, its debts have been paid and its assets have been distributed (in accordance with the Companies Act 1993 and the company constitution), or
  - it has no assets and no creditor is seeking to liquidate the company.
- Written notice from the IRD stating that the Commissioner has no objection to the company being removed from the register (once the final tax return(s) and a business cessation form has been lodged).

The Registrar of Companies will then publish a public notice of the intention to remove the company from the register (in the New Zealand Gazette and another newspaper). Once a 20 day notice period has expired the Registrar will remove the company from the register if no objections are received.

Solvent liquidation

A liquidator is appointed by shareholder resolution. The liquidator then consents to the appointment and gives notice of it to the Companies Office. The directors must pass a resolution as to the solvency of the company and file it with the Companies Office within 20 working days of appointing the liquidators.

A notice of appointment and notice to creditors to claim (minimum 10 working days' notice) is published in the New Zealand Gazette and one other newspaper. The liquidators' first statutory report is filed at the Companies Office with copies to the shareholders and any creditors.

When the notice period for creditors to claim has expired and assets distributed and liabilities discharged, the liquidation is completed by the filing of the liquidators' final statutory report at the Companies Office, with copies to shareholders and all known creditors.

A final public notice of intention to remove the company from the register is published in the New Zealand Gazette and one other newspaper (minimum 20 working days' notice for objections to the removal). Provided that no objections have been received, the company is removed from the register at the expiry of the period of notice.

Summary

As illustrated, there are different processes and benefits under each method. Generally, the short-form removal process is best suited to a company that has one or more of the following features - has little trading history, has held few assets, is subject to low commercial risk, and no contingent liabilities.

A solvent liquidation involves slightly more paperwork and generally costs more than a short-form removal. However, if the most important consideration is to minimize the risk of the company being reinstated through creditor claims after the company is struck off from the register, then the best option will be to complete a 'solvent liquidation'.

Snippets

Summary of IRD rates

Use-of-money interest - the rates on underpaid and overpaid tax rose on 8 May 2015. The interest rate charged on underpaid tax went from 8.40% to 9.21%, and the rate for overpaid tax rose from 1.75% to 2.63%. This movement aims to align the rates with the market interest rates and were last updated in May 2012.

ACC earners levy rate - the ACC earners levy rate for the 31 March 2016 year is 1.45%, the same rate as last year. For employees, the maximum earnings on which the levy is payable is $120,070.

FBT rate for low interest loans - the last notified prescribed rate of interest used to calculate fringe benefit tax on low-interest employment-related loans was 6.70% for the period 1 October 2014 to 31 December 2014. This was up from the previous rate of 6.13%.

Personal marginal tax rates - no changes are proposed to the income tax rates for individuals for the 2016 tax year. The lowest marginal tax rate is 10.5% for taxable income up to $14,000, then 17.5% up to $48,000, 30% to $70,000 and the top rate is 33% on income over $70,000.

Pan tax

Of all the weird and wonderful taxes imposed around the world, it was surprising to find one in our own back yard. New Plymouth sports clubs pay tax on the number of toilets they have. This 'pan tax' is imposed by the council and is effectively a sewer charge.

The problem is that sport clubs have limited cash flow and are struggling to meet their liability. According to media reports, the pan tax is often one of the biggest expenses incurred by clubs, and members believe it is not a fair expense. "People already pay pan tax at home. It doesn't matter if you are going at home or at the club, you've already paid for it" said a local club member.

Club calls to flush this tax down the drain have resulted in the Council reviewing the tax in their latest public consultation document.

If you have any questions about the newsletter items, please contact me, I am here to help.