

NEWSLETTER



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Health in the workplace

How often have you found yourself vowing to improve your health or fitness? If you are anything like the majority, chances are at some point you have embarked on some fad diet or joined the latest fitness craze in an attempt to get healthier, only to find yourself succumb to the temptation of those pesky workplace morning teas or 3pm sugar cravings. However, with workplace well-being programs continuously growing in popularity, could the workplace soon provide more health-help than harm?



A recent survey by AON suggested that promoting good health and wellness should be a goal of all employers in 2018, with 96 percent of respondents recognising a connection between health and work performance. Perhaps one of the most popular trends already seeing widespread adoption is the introduction of standing desks. For office based employees, the majority of the day is spent sitting at a desk, resulting in lengthy periods of sedentary activity. Such high levels of sedentary behaviour allegedly have a major effect on a person's health, with links to both physical and mental conditions, including obesity and depression. Thus, standing desks should help ease this effect by reducing the amount of time a person is sitting down.

In addition to increasing employees' activity levels, nutrition is also a key component. It is well established that what we eat has a greater impact on our health than the amount of exercise we do. It has been estimated that we eat approximately a third of our day's food at work, meaning the workplace is an ideal place to assist employees in making healthy choices. Initiatives such as offering complimentary fruit, ensuring any food provided is as healthy as possible, and limiting the supply of alcohol, are small steps to encouraging employees to make healthier choices. For those interested in more quirky initiatives, perhaps

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implementing an “on-the-hour flash walk” is something to consider. A “flash walk” has been said to generate collective positive energy, as well as provide a break from sustained periods of sitting or standing. Additional physical and psychological benefits are thought to contribute to decreased healthcare costs for companies in the long run.

Sleeping on the job has been a big no-no in the past, however studies have proven that even a 20-minute power nap can reduce stress and increase productivity. Tech giants like Google and Uber are paving the way for workplace naps, introducing in-company sleep pods and resting

rooms. For companies that are not quite sold on the idea of employees napping at work, investing in sleep awareness and education programs could be a beneficial alternative to combatting the decrease in productivity caused by sleep deprivation.

It is apparent that investing in the physical and mental health and wellbeing of employees stands to facilitate a healthy and productive workplace. With growing support and commitment towards promoting good health and wellness, expect to see some more innovative health initiatives develop in 2018.

Ring-fencing rental losses

Labour’s pre-election manifesto proposed to increase the fairness of the tax system and improve housing affordability. In the six months since the Labour-led coalition entered Parliament, we have started to see some changes filtering through. As part of the proposals aimed at house prices, Inland Revenue has recently released an Issues Paper proposing to ring-fence rental losses, with draft legislation likely to follow once Inland Revenue has considered public responses. So how would the rules work?



People derive income from multiple sources, such as salary / wages, business income, interest, dividends and rental income. It is a fundamental feature of NZ’s tax system that a person is taxed on their total income from all sources, whether a profit or loss.

This aggregation allows losses incurred from rental properties to be offset against other income, reducing a taxpayer’s total income and corresponding tax liability. The Government’s concern is that this mechanism allows property investors to take on high levels of debt to finance their property investments, giving rise to tax losses, effectively subsidising the rental portfolio through a reduced tax liability. The high-gearing offers an advantage compared to owner-occupiers because their interest cost is not tax deductible.

The proposed ring-fencing rules contained within the Issues Paper will eliminate this advantage by preventing rental losses from being offset against other income. Instead, rental losses will be ‘ring-fenced’ and offset against future rental income, or any tax incurred on the future sale of the property.

Labour originally indicated losses might be ring-fenced by individual property. Thankfully, the proposed ‘portfolio approach’ is more logical,

enabling investors to pool their profits and losses from all residential properties, including overseas properties. If enacted, the rules will apply to all rental properties irrespective of how they are held, i.e. the rules will apply to individuals, companies and trusts. The proposed rules also use the existing definition of ‘residential land’. Thus, the rules will not apply to commercial property or property subject to the mixed-use asset rules.

There is complexity in the new rules because they can impact people that don’t hold rental properties. For example, if a person has borrowed to purchase shares in a company and that company uses the funds to purchase a rental property, the interest incurred by the shareholder is normally tax deductible. In this situation, if 50% or more of the company’s asset value is derived from residential properties the company will be classified as “residential property land-rich”. Amounts paid to the shareholder (e.g. dividends) will be classified as “rental property income” and their interest expense will be classified as “rental property loan interest”. The rental interest can only be deducted against “rental property income” derived from the company, or the individual’s other rental properties, with any excess loss ring-fenced to the person.

The application of the proposed 50% asset test is currently unclear – the issues paper does not indicate whether it will be based on market value or historical cost. This will undoubtedly be addressed during the consultation period. If enacted, the proposed rules may be phased in from the start of the 2019 – 2020 income year. This will allow investors time to adjust to the new rules and provide the opportunity for taxpayers to rearrange their affairs before the rules are adopted in full.

Bright-line breach warning

The bright-line test came into force from October 2015, introducing rules that a profit derived on the sale of a residential property is subject to tax if sold within two years of purchase, albeit subject to some exceptions such as the family home. These rules have recently been revised to extend the bright-line period from two years to five.



Whilst the bright-line provisions appear relatively straightforward, there are some intricacies to the rules, so it is advisable to seek professional advice before selling a residential property. A recent High Court decision highlighted the potential consequences of failing to seek sufficient advice.

The case involved Mrs Blackburn, who personally owned a property on Waiheke Island for a number of years, before selling it to her family trust for \$2.85m on 31 March 2016, 6 months after the introduction of the bright-line test. The following year, the Trust sold the property to a third party for just over \$5m. Although Mrs Blackburn had owned the property for several years, the trust is a separate taxpayer for the purpose of the bright-line provision, hence the profit derived on sale of the property was taxable. However, the Trustees did not return the sale in their tax return and IRD later assessed them for income tax, resulting in a tax liability of approximately \$775,000.

Displeased with this outcome, the Trustees applied for a summary judgement against their accountants, seeking \$785,696.09, claiming that

if they had known a tax liability would be incurred, they would not have entered into an agreement to sell the property. Since 2013, the Trust had received regular accounting services and tax advice from their accountant. However, the Trust had engaged a

lawyer specifically in relation to the sale of the Waiheke property. The lawyer raised the concern with the Trustees that any gain on sale would be subject to income tax under the bright-line test. Hence, the Trustees should have been aware of the tax position.

However, the Trustees alleged that they also sought their accountant's "thoughts" on the proposed sale, and the accountant did not raise any concern that a tax liability would be incurred. In the absence of any concern, the Trust went ahead with the sale.

In court, the accounting firm argued that the Trust had not sought specific tax advice regarding the sale of the property. It was also asserted that the Trust had already received advice from their lawyer advising them that the sale would be captured under the bright-line test. The judge ultimately dismissed the Trustees summary judgement application on the grounds that the Trust was unable to establish beyond reasonable argument that there was a formal request for advice.

The case acts as a timely reminder that when seeking advice, the scope of services should be clearly agreed between you and your lawyer or accountant, so there is no doubt on either side.

Reimbursing allowances



On 3 April, Inland Revenue issued a draft 'Questions we've been asked' (QWBA) covering the tax treatment of allowances and

benefits paid or provided to farm workers. A key principle covering such payments centres on the tax treatment of 'reimbursing allowances' – this is relevant not just to farm workers but all employees.

Reimbursing allowances are paid to employees for expenses incurred, or likely to be incurred, in connection with their employment, e.g., vehicle mileage and tools. Section CW 17 of the Income Tax Act contains the requirements that must be met for such payments to be received tax-free

and one of the key tests is that the expense incurred must be a 'necessary expense' incurred in performing the employment duties.

Furthermore, if employees were allowed to deduct expenses incurred to derive salary or wages, the expense would need to qualify as tax deductible. For example, if an employee was instead self-employed and the expense was tax deductible because it was incurred to derive their self-employed income, the test would be met.

A self-employed person can't deduct the cost of a motor vehicle used to derive income because the expense would be capital in nature. Therefore, an employee cannot be paid a tax free reimbursement for the cost of their vehicle. However, vehicle running costs would be tax deductible to a self-employed person, and

therefore an employee can be paid a tax-free amount to cover such costs.

The draft QWBA also includes an example of depreciable farm machinery used both in the farm business and privately. In this scenario, an apportionment of the reimbursement would be required, with the business portion of the reimbursement being tax-free, whilst the private portion would be taxable to the employee and subject to PAYE.

In addition to reimbursing specific expenses, allowances can be paid tax free based on a reasonable estimate of the expenditure. The estimation should have some reasonable basis, such as historical data, industry standard, or employee survey information. The employer must also keep sufficient information about the calculation method, and review the amount periodically to ensure the estimate remains reasonable.

Dividend stripping

Business structures tend to evolve gradually over time, and many successful commercial operations grow by adding additional companies or trusts on an ad hoc basis, until the resulting structure becomes somewhat unwieldy. There is then a need to streamline the business's legal structure by inserting a holding company, providing a common point of ownership and simplified management and administration.

However, a provision within the Income Tax Act, commonly referred to as 'dividend stripping', risks such innocuous restructures being challenged by IRD as a tax avoidance arrangement.

A dividend strip occurs when a 'sale of shares' occurs in substitution for a dividend, the following is a simple example:

- Mr A owns 100% of the shares in OpCo, which has retained earnings of \$1m.
- Mr A incorporates a new HoldCo, in which he holds 100% of the shares.
- Mr A lends \$1m to new HoldCo and HoldCo uses the loan to purchase OpCo's shares off him for \$1m.
- OpCo pays the retained earnings to Hold Co as a tax free dividend.
- HoldCo repays the \$1m loan to Mr A.

The above arrangement has allowed Mr A to receive the retained earnings tax free. The dividend strip provision deems the amount

Reimbursing allowances can sometimes be paid tax-free to independent contractors, for example where they receive scheduler payments. This is based on the assumption that the contractor would generally be able to deduct the expenses to which the allowance relates.

However, this raises the issue of whether the contractor is entitled to deduct the expenses as well as receive a tax-free reimbursement, effectively creating a 'double deduction'. The draft QWBA clarifies that this is not the case; if the allowance is treated as exempt income, the contractor is denied a deduction for the attributable expense.

The tax treatment of reimbursing allowances is a 'standard' area of focus by Inland Revenue when reviewing a taxpayer's affairs, hence it is worthwhile checking to make sure they are being treated correctly.

received by Mr A on sale of the shares in OpCo to be a taxable dividend.

Inland Revenue released Revenue Alert 18/01 in January which sets out the Commissioners current view on dividend strips, and asserts that the provision can apply in a range of circumstances. Although the dividend strip provisions have been around for some time, the 'tax avoidance' landscape has changed in recent years and can arguably apply in wider circumstances than previously thought.

For businesses seeking to restructure without gaining a tax advantage there is the option of inserting a holding company by way of 'share for share' exchange, which should ensure no dividend strip arises. Under a share for share exchange Mr A would swap shares in OpCo for shares in the HoldCo. No cash changes hands and there is no need for debt. Under the 'share for share' exchange provisions, the subscribed share capital in HoldCo mirrors that of OpCo, i.e. a neutral result. However, in practice, if OpCo had capital reserves there is a risk a share for share exchange converts these into taxable revenue reserves due to a disconnect with the 'capital gain' provisions in the tax act. Therefore, the share for share provisions can create a significant tax disadvantage.

Given the dividend strip risk combined with what appears to be a flaw in the share for share provisions, in some cases it is simply not possible to implement commercial restructures.

Given the current landscape, anyone considering a restructure of their business holdings needs to be extremely cautious of the dividend strip provisions, not only to avoid a tax avoidance

challenge by IRD but also to avoid any adverse tax consequences caused by seeking to counter these provisions.

Snippets

Cryptocurrency and tax

Over the last decade, the use of digital or virtual currencies, known as “cryptocurrencies”, has grown dramatically in popularity. A single piece of Bitcoin is currently valued at over \$9,000 NZD. Some New Zealand retailers have already begun accepting Bitcoin as a form of payment, which has led to the Inland Revenue releasing a ‘Questions & answers’ considering the tax treatment of cryptocurrency.



For tax purposes, cryptocurrency is treated as property, which means that foreign currency gain or loss provisions do not apply. However, if a New Zealand business accepts cryptocurrency as a form of payment, the amount is treated as taxable

business income based on the value of the cryptocurrency at the time it is received.

Any gain on sale of cryptocurrency is assessed by considering the original purpose for acquiring the currency. If the currency was acquired with the purpose of disposal, any proceeds made from selling the currency are taxable. IRD consider the nature of cryptocurrency means it is unlikely that a person would acquire it without the intention to sell or exchange it, meaning the majority of gains made on disposals would give rise to a tax liability.

If you invest or trade in cryptocurrencies, be sure to keep an eye out for further developments from Inland Revenue, as they intend to refine its tax treatment as more information becomes available. .

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