ARMSTRONG HOTCHIN & Co

ACCOUNTING | TAXATION | BUSINESS SERVICES

NEWSLETTER

Issue 2
May – July 2020

INSIDE THIS EDITION

Emerging from Covid-19 ..... **1**

GST issues paper **2**

Carry back of tax losses **3**

Other tax changes in response to Covid-19 ..... **3**

Snippets **4**

Can you steal GST? *4*

Lockdown *4*

Emerging from Covid-19

As New Zealand moves down the COVID-19 alert levels businesses face a long transition period from the unknown to the 'new normal'. Social distancing, strict health and safety guidelines, restricted international and regional travel are amongst numerous practises that will likely continue to apply for as long as COVID-19 remains a global threat. This may mean a need to increase online presence, re-focus on the domestic market, or implement a completely new model of operation. Consideration should be given to the following areas.

Employees: Not all employees will be able to return to work as needed. Employees with underlying health vulnerabilities or family members that cannot risk exposure, may not be able to return to work. Therefore, businesses need to question whether they will have sufficient resources to commence operations and/or how can they function with a potentially smaller team. Pressuring employees deemed vulnerable could be in violation of the Health and Safety Act, potentially comprising failure to maintain a safe work environment. Early discussions with staff will enable a phased plan to be developed.

Supply Chain: Are products sold to, or suppliers based in, or product transported through a Covid-19 affected market? These are important questions to answer before resuming operation because disturbances in the supply chain will impact a businesses' ability to trade. As more businesses recommence operations at lower alert levels how does this impact supplier's ability to deliver on time and to requirements? In a changing business environment, certain materials will likely be in short supply and alternatives needed, competitors will pivot into different markets and customer demand and behaviour will change. For example, prices previously established based on a particular

experience or demand will need to be 'reset' if the experience or demand has changed.

Marketing: Brick and mortar retail stores may need to establish an online presence. Physical displays and signs on the streets will be irrelevant if there is no foot-traffic to capture the target audience. Therefore, utilising social media platforms, expanding and upgrading the business website, enabling 'click and collect' services and/or a delivery function will be an essential. However, this may not be possible if website and app designers are overrun with demand.

Cash-flow/banking relationships: Adapting the business to the 'new normal' may require additional cash-flow. With on-going overheads and limited revenue this is a fundamental challenge. Levers need to be pulled. Deferred payment terms could be negotiated with suppliers to enable a cash shortfall to be bridged as revenue streams start to resume. And periodically review your customers' circumstances to confirm they are able to pay, come time to do so. New revenue streams could be secured by offering more favourable payment terms than competitors (for a fixed period) - but care needs to be taken to ensure you are not starting a race to the bottom.

Discussions with the bank are vital. Reassessing and confirming banking arrangements, extension of overdraft limits to meet short-term cash-flow requirements, and capacity for long-term funding. Consider all avenues in assessing what resources are available to assist with cash-flow, and ultimately, plan for cash-flow requirements for the next 6-12 months to identify peak funding requirements. Create 3 models, based on worst-case, expected and best-case scenarios. If a business can quantify cash-flow requirements and timing of when this is required, this will lead a more needs focussed conversation with the bank.

These are just some of the aspects to contemplate as businesses implement a COVID-19 recovery plan. Businesses that have a clear vision and plan ahead are more likely to emerge out the other side.

GST issues paper

On 24 February, Inland Revenue released an Officials' Issues Paper seeking feedback on various GST issues.

A long-standing rule that has proved a source of frustration for those affected applies to transfers of goods between associated persons. The issue is highlighted in the following example. Joe buys a block of land on the edge of town from a third party. Neither the vendor, nor Joe, are GST registered, i.e. GST does not apply. Joe holds the land for a number of years and due to urban expansion, the opportunity arises to subdivide the block into 6 lots for sale. Joe incorporates a company to complete the subdivision and sells the land to the company.

Because of the work required to complete the subdivision, it comprises a 'taxable activity' and GST applies to the sale of the 6 sections. However, under current rules, the company is not entitled to a GST deduction on the purchase of the land, i.e. GST is paid on the sale, but can't be claimed on the purchase. The problem arises because Joe's GST deduction is limited to the amount of GST he originally incurred, which in this case was zero as GST did not apply to that transaction.

Officials now consider it appropriate for Joe to be entitled to a GST deduction. It is proposed that Joe should be entitled to a deduction based on 3/23rds of the price paid for the land. Arguably, the GST deduction should be based on the land's market value. By restricting it to 'cost', GST is effectively being levied on the increase in the value of the land when it was held 'privately' by Joe. Changes are also proposed to the apportionment and adjustment rules that apply when goods and services are used for both taxable and non-taxable purposes. With the increased popularity of Airbnb, these rules have increasing application. Broadly, the current rules require a person to make periodic GST adjustments for any difference in the intended taxable use of an asset and the actual taxable use. One of the issues contained within the Issues Paper is what happens when the asset is sold or deemed to be sold.

For example, if a bach, sold by a GST registered vendor, has been used 30% for Airbnb, GST is paid on the full value of the sale, but an offsetting GST deduction is allowed based on the 70% proportion of private use, i.e. GST is paid on 30% of the sale proceeds. In isolation, this would arrive at a logical outcome. However, the offsetting deduction is limited to the amount of any unclaimed GST from the original purchase. This means that for an appreciating asset, GST becomes payable on the full capital gain since acquisition, with no offsetting GST claim.

Within the issues paper it is acknowledged that the cap on the 'wash-up' deduction gives rise to "over taxation". The suggested solution is to remove the cap (for non-property developers). This would ensure GST is paid in-line with the extent the property has been used to make taxable supplies (30% in the above example). However, this would be calculated on the capital gain since acquisition, which could include when the property was not used to derive income.

Changes to make the rules fair are welcomed, the question becomes whether they will go far enough.

Carry back of tax losses

Ordinarily, if a taxpayer incurs a tax loss within a particular year, they are able to carry that loss forward and offset it against income derived in a future year, thereby reducing the taxpayer's future tax payable. As part of the Government's Covid-19 response, on 30 April 2020 legislation was passed under urgency which allows tax losses to be offset against income derived in a previous year, thereby enabling the taxpayer to obtain a refund comprising prior year income tax paid. This temporary tax loss carry-back scheme is available to most taxpayers, e.g. trusts, companies and individuals.

A permanent scheme to replace the temporary rules is under development and will apply from the 2022 income year, however, the current scheme applies for a two-year period as follows:

- A tax loss incurred in the 2020 income year is able to be carried back and offset against taxable income derived in the 2019 income year.
- A tax loss incurred in the 2021 year is able to be carried back and offset against taxable income derived in the 2020 year.

A tax loss cannot be carried back multiple years, instead it applies to the "net loss year" and the immediately preceding "taxable income year".

Taking each year in succession, most taxpayers will have already filed their 2019 income tax return, but a request to amend that return can be made via MyIR or a letter can be sent to IRD requesting a reassessment (pursuant to section 113 of the Tax Administration Act 1994). The loss amount can be determined by either preparing a 2020 tax calculation based on 'actual' results or preparing an estimate. The ability to make an estimate allows taxpayers to access the refund faster. However, if an estimate of the 2020 tax loss is later found to exceed the actual loss amount, tax will need to be repaid to IRD, on which interest will apply.

With respect to utilising expected losses in the 2021 year against profits derived in the 2020 income year, in most cases the 2020 income tax return would not have been filed and may not be filed for some time, however 2020 provisional tax may have been paid to IRD. To enable provisional tax payments to be refunded, taxpayers will have the option of submitting an estimate of their 2020 provisional tax liability (that takes into account expected losses for 2021) – the time to do so has been extended to when the tax return is filed. Excess tax paid, based on the provisional tax estimate, will be refunded.

If a company incurs a loss and it is a member of a wholly owned group of companies, it can only carry back the amount that can't first be offset against the income of other companies in the group.

If taxable income for the 2019 year was paid by way of shareholder salary, this cannot be reversed under the tax loss carry back initiative. However, provisional tax paid for the 2020 year in relation to an expected shareholder salary could be refunded under the initiative.

Under ordinary rules, 49% shareholder continuity must be maintained from the time a loss is incurred until it is utilised. A similar rule will apply to the loss carry back scheme, i.e. if there has been a change in ownership that breaches the threshold, a tax loss cannot be offset against income derived prior to the breach. However, part period calculations can be completed, as applicable.

The pragmatism underpinning this scheme will be appreciated as it allows sound businesses to secure a refund of tax paid in better times.

Other tax changes in response to Covid-19

In addition to the tax loss carry-back scheme, the New Zealand Government has introduced a number of other tax changes to assist businesses and individuals to get through COVID-19.

Currently, if an asset is purchased for less than $500 it does not need to be depreciated. The cost is immediately deductible in the year of purchase. This 'low-value asset' threshold has been temporarily increased from $500 to $5,000 for assets purchased in the 12 months from 17 March 2020. The threshold will reduce to $1,000 for assets purchased from 17 March 2021.

Tax depreciation on industrial and commercial buildings has been re-introduced for the 2021 tax year and onward. The diminishing value rate will be 2%, while the straight-line rate will be 1.5%. This is a permanent measure which will have a flow-on effect and improve the balance sheet of some large companies through the partial reversal of deferred tax liabilities.

The residual income tax threshold, which determines whether a taxpayer has a provisional tax obligation has been permanently lifted from $2,500 to $5,000 for the 2020-21 income year and onward. This is expected to remove 95,000 taxpayers from the provisional tax regime, assisting cash-flow and

compliance related issues faced by individual taxpayers and small businesses.

Taxpayers affected by COVID-19 that are unable to physically or financially make tax payments will not be charged use of money interest (UOMI) on late payment of taxes from 14 February 2020. However, taxpayers will need to demonstrate to IRD that they have been "significantly adversely affected". IRD is further offering taxpayers the opportunity to set up instalment arrangements to meet outstanding tax liabilities to those facing difficulty in paying outstanding amounts. Amendments to the Tax Administration Act 1994 have been made to give IRD greater discretion over its ability to allow extension of due dates and filing timeframes for taxpayers affected by COVID-19.

Changes to the tax loss continuity rules will be introduced. At present, an entity is only able to carry forward tax losses if shareholder continuity of 49% is maintained from the time a loss amount is incurred, until it is utilised. A 'same or similar business' test has been proposed, whereby a business can carry forward tax losses provided it continues to operate in the same or similar way, irrespective of a change in ownership. This test is being modelled on the current Australian loss carry forward rules. The change is targeted at taxpayers who are seeking new capital to stay afloat, without tax losses being forfeited due to a change in ownership. A 'same or similar business' test aims to instil confidence in prospective investors as to future cash-flow benefits from utilising the current period losses against future profits.

Finally, the extension of the new R&D tax credits rules to companies that incur tax losses, initially intended to be enacted effective from the 2020-21 tax year, has been brought forward to the 2020 tax year to allow timely access to the regime.

The package contains a number of measures designed to provide cashflow advantages. Hopefully there is something for everyone.

Snippets

Can you steal GST?

Whether a price includes GST or not is important to know for the price of a product. In the case between the New Zealand Police and Genesis Pure, 'GST' became the difference between a maximum penalty of seven years in jail, or one.

Mr Pure was charged with stealing an iPhone and Sim card from The Warehouse. The retail prices was $1,004, including GST. The maximum sentence for theft exceeding a value of $1,000 posed a maximum penalty of imprisonment for seven years. However, Mr Pure contested that the value of the iPhone exceeded $500 but not $1,000 because the GST exclusive price was less than $1,000, which carries a maximum term in prison of one year. The District Court agreed with Mr Pure on the basis that The Warehouse would not be obligated to pay GST to IRD for the stolen items. To penalise Mr Pure based on the GST inclusive value was deemed to overcompensate the victim in this instance and produce an unfair outcome for the defendant, especially when the value of theft only marginally exceeded the threshold for higher penalty.

The New Zealand Police did not agree with the above view and has requested a leave to appeal to the High Court. In considering the leave to appeal, the High Court looked at what defines 'value'. Various cases in overseas jurisdictions provide different views and the Goods and Services Act 1985 does not help.

Ultimately, the High Court viewed value to be objectively considered, not from the perspective of the victim or culprit. The appeal has been allowed and whether the Police pursue prosecution to reflect value in excess of $1,000 remains to be seen.

Lockdown

As we moved into Alert Level 4, it took some time for the rules to be refined and communicated. Not to make light of the importance of the rules, other countries have adopted some 'interesting' rules.

Panama implemented 'gender' isolation. People could only leave their homes for certain hours of the day, but in some hours Panama restricted this to only females, and during other hours only males. In Colombia movement was limited based on national ID number. Barrancabermeja only allowed those individuals with ID numbers ending in 0, 7 or 4 being allowed out on Monday, while 1, 5, and 8 can go out on a Tuesday. Spain prohibited physical exercise during the lockdown, and as one individual found out, this included cycling to work.

In Michigan, Home Depot was allowed to stay open, but part of the store was closed off. One customer commented you could put up Gib, but you couldn't paint it.

Then when it comes to policing the lockdown and identifying cases of Covid-19, a town in Connecticut is a testing lab for a surveillance programme that uses a new type of drone to identify symptoms from the air.

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