BC'S BUSINESS BRIEFS

Tax rate changes – an initial salvo from the first majority government under MMP?

Making good on their election promise to raise the rate of income tax for all individuals earning over $180,000pa, the government introduced to parliament an amendment to the Income Tax Act 2007 on 2nd December. The Taxation (Income Tax Rate and Other Amendments) Bill - as it was known - received its first, second and third readings the same day and was duly passed – also on the same day. The Bill received Royal Assent on the 7th December 2020 and therefore became law. The speed with which the legislation went from a Bill to law – 5 days – is only possible because we have a true majority government meaning that there was no consultation and limited debate.

The new higher rate will apply from 1 April 2021. Along with the higher income tax rate, changes have been made to PAYE rates, FBT rates and other withholding taxes to align with the 39% income tax rate.

The Bill contained a number of other provisions as well, which have had minimal coverage. While the government stated they would not make any other changes to tax rates (it is arguable they didn't despite an increase in FBT and withholding tax rates to align with the new higher rate) increased requirements for Trustees to provide information to IRD have been introduced.

The additional reporting requirements on Trustees appear to be an effort by IRD to ensure they have sufficient information to make a judgement on whether taxpayers have altered their tax affairs to avoid the new 39% tax rate.

In addition to information required in each Trust tax return presently, trustees will be required to provide the following additional information to IRD;

1. A Profit and Loss Statement and Balance Sheet annually;
2. The amounts and type of each settlement made on a Trust in an income year;
3. Details of the settlors names, date of birth, tax residence and IRD number. This can be very easily wider than just the named settlor or settlors in a trust deed. It includes anyone who is deemed to make a settlement under income tax laws. As an example, something as simple as an interest free loan from income allocated to a beneficiary that remains undrawn at Balance Date can constitute a settlement and the Beneficiary could therefore effectively become a settlor of the trust;
4. Details as above in (3) for any person who has the power to appoint trustees, amend the trust deed or add or remove a beneficiary;
5. For each distribution made by the trust (either as beneficiaries income or a capital distribution), the trustees must provide the amount of the distribution and details of the recipients name, address, IRD number and date of birth.

While not all the items listed are new requirements, a significant number are and accordingly it is to be expected that the compliance costs associated with complying with trust tax law is likely to increase over the next few years.

The implications of these changes for NZ taxpayers affected by them appear to be clear. If you make changes to the way your affairs are structured that result in earnings dropping from recent history and as a result, you obtain tax advantages by way of falling out of the 39% tax bracket, you can expect the IRD to be looking and asking questions. If your affairs are structured in a similar fashion to the recent past, you are less likely to come in for scrutiny. The paying of 'market rate' salaries in closely held companies will inevitably come in for attention and the old classic tax case precedent "Penny & Hooper" will inevitable receive more attention.

The "Penny & Hooper" case revolved around a partnership of two medical professionals who restructured their affairs from a partnership to another structure at the beginning of their tax year. This effectively lowered their personal incomes by hundreds of thousands of dollars and instead of the profits being taxed (effectively) at 39%, they were taxed at the trustee rate of 33%. The IRD determined the restructuring was predominantly 'for the purpose of' avoiding tax, and the court agreed with them, unwinding the tax effect of the changes. The case is the most recent case of its type that has a significant effect on what is and isn't permissible around restructuring and tax avoidance implications.

Office Hours over the Xmas break

Like most people, we are certainly looking forward to the Xmas break this year. It goes without saying this has been a year like no others in most of our memories. A couple of more senior people I have spoken with noted the closest thing they could recall to this year was the polio epidemic which afflicted New Zealand between 1948 and 1956 – albeit in three different waves during that period.

We will be closed from 5pm Tuesday 22nd December until 8.30am Monday the 18th January. During that time, our phones will be diverted to my cellphone and I will have access to email, so should you require urgent service, I should be able to assist.

In the meantime, thank you for your business this year, have a Merry Xmas and bring on an improved 2021!

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