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2015 Tax Bill released

The Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill (the "Bill") released last week includes new rules to cash-up R&D tax losses for start-up businesses, clarifies the GST treatment of bodies corporate, and contains various remedial changes to New Zealand's international tax rules.

The main proposal in the Bill is to refund R&D tax losses. While welcome, there are a number of detailed design issues to be worked through.

The Bill also clarifies the GST treatment of bodies corporate. This is strongly supported as it will provide flexibility to affected taxpayers.

R&D tax loss cash-up

The Bill will allow certain businesses to cash-up tax losses generated from certain qualifying research and development ("R&D") activities, from 1 April 2015. To qualify, a business will need:

- salary expenditure on R&D equal to at least 20% of their total labour expenditure ("R&D wage intensity test"). This is tested at the group level if the company is part of a group of companies; and
- to be a New Zealand resident company that is not a Look Through Company (or qualifying company) and not part of a group that includes a foreign company.

The amount cashed-up is the lower of 28 percent of:

- net losses up to $0.5m in 2015-16 (i.e. a refund of up to $140,000) rising by $0.3m each year to $2m by 2020-21;
- the total qualifying R&D spend; and
- 1.5 times the salary expenditure on R&D.

Any loss cash-up will need to be repaid if the company sells the resulting R&D asset, more than 90% of the company is sold, or the company is liquidated. The losses will then be reinstated.

KPMG comment

The proposal was first raised in 2013 and confirmed in last year's Budget. It is aimed at alleviating cash-flow problems for start-up companies, many of which struggle for positive cash-flow when the business needs it the most. While the proposal is welcome there are a number of hurdles to qualify, including a strict definition of eligible R&D (e.g. R&D activity undertaken offshore will be excluded), that will need to be worked through. As with any income tax based policy, a business will only receive the cash when they file their tax returns. This will generally be after the cash is spent as most companies have 12 month or longer to file their returns.

The 20% R&D wage intensity test means the proposal will be of limited value to most medium to large businesses. However, they may qualify for other assistance. Much of this is outside the tax system.

One of the challenges for business is understanding the different types of Government assistance that is available. Businesses need to do their homework as the Government has committed significant funding for R&D and innovation but only a fraction of this is currently being accessed. There is also a role for advisors, the Government and its agencies in better communicating and socialising the available R&D assistance with the business community.

Black hole expenditure

The Bill allows the following types of non-deductible and non-depreciable (i.e. "black hole") expenditure to be claimed, from the 2015-16 income year:

- A deduction for non-depreciable intangible assets will be available when the asset is derecognised for accounting. This deduction will be clawed-back if the asset is sold or becomes useful again.

- The cost of a depreciable asset (such as a patent) will include amounts which are not currently included in the asset's depreciable cost base (e.g. because the expenditure does not directly relate to the patent application).

- Design registrations and industrial copyrights will be added to the list of depreciable assets.

KPMG comment

These proposals were also confirmed in Budget 2014 and are a useful extension of the deductibility and depreciation rules to capitalised costs (mainly relating to the "development" phase of R&D) which are currently not claimable. KPMG believes that the issue of black hole expenditure, generally, needs to be looked at and dealt with comprehensively rather than in the current ad hoc manner.

GST and bodies corporate

The Bill will treat body corporate fees, which are used to fund expenditure such as building maintenance, insurance and security, as supplies for GST purposes. This will mean that a body corporate is required to GST register if its total supplies, including those to members, is greater than $60,000 annually.

However, the Bill effectively allows a body corporate to treat member fees as exempt GST supplies. This means a body corporate is only required to register for GST if supplies to non-members exceed $60,000. The net result is that:

- Bodies corporate that have already GST registered can continue to remain registered. However, if they deregister they will not receive refunds of GST paid on member fees held at the time of de-registration.

- Bodies corporate that have not GST registered can continue to remain un-registered if supplies to non-members remain below $60,000. However, if a body corporate registers, it will have a one-time GST cost based on cash and non-cash investments held at the time of registration and ongoing GST obligations (e.g. to pay output GST and claim input GST on expenditure).

KPMG comment

We strongly support the approach in the Bill to the GST treatment of bodies corporate. This issue arose when Inland Revenue reached a view early last year that bodies corporate were making supplies to their members. This created concern as some bodies corporate were claiming and paying GST while others (a large majority) were not. This prompted consideration of a possible law change.

The Government's original proposal was to treat bodies corporate members' fees as GST exempt in all cases and deny GST claims on bodies corporate expenditure. That would have resulted in considerable compliance costs, including having to repay previous GST refunds and/or claim back GST already paid. You can read KPMG's submission on that proposal here.

The solution in the Bill is more workable and pragmatic. It provides taxpayers with flexibility to keep doing what they are doing or to change their GST position, prospectively, if so desired. However, it also means that bodies corporate and their members who have been taking a "practical" approach to claiming GST refunds, by members claiming their respective share of input tax, may need to register for GST.

International Tax changes

The Bill contains a number of policy and remedial changes to the Controlled Foreign Company ("CFC"), Foreign Investment Fund ("FIF") and new Foreign Superannuation tax rules.

From 1 April 2016:

- A choice of an annual or more frequent (e.g. daily) basis for calculating Fair Dividend Rate ("FDR") income will be available only once every four years. Currently, an annual FDR method can be used when share values are increasing and the unit valuation period FDR method when share values are falling. The advantage is that market values can be reset, or not, during the year to minimise the value upon which FDR income is calculated.

- The normal pre-paid expenditure spreading rules will apply to the expenditure of CFCs. The concerns is the current rules allow immediate deductions for expenditure that should be spread.

- It will not be possible to cherry pick the application of the CFC test group rules when applying the active business exemption. For example, consolidating active CFCs with passive CFCs when the latter has income, to access the active exemption for the group, but not when the passive CFC has losses (as these can be carried forward).

Other CFC changes include:

- Allowing groups of foreign companies acquired (or disposed of) during a year to be included in CFC test groups.

- Clarifying that the personal services attribution rule, or the CFC rules, can be used for attributing income if personal services are provided through a foreign company. Currently both rules apply, with the CFC rules a more complex undertaking.

- Aligning the income attribution for FIFs held directly and indirectly through a CFC.

Various tweaks are also proposed to the recently enacted Foreign Superannuation tax rules, including:

- Confirming that the new rules, rather than the FIF rules, apply to foreign superannuation scheme interests acquired when a person was NZ tax resident but non-resident under a Double Tax Agreement ("DTA").

- Application of the new rules for foreign superannuation scheme interests, rather than the FIF exemption, where holders' foreign superannuation scheme interests (combined with other FIF interests) have a cost of NZ$50,000 or less. This change will apply from 1 April 2015.

- Confirming that where pensions have been returned as taxable income prior to 1 April 2014, individuals will not be penalised for FIF non-compliance, if those rules should have applied instead.

KPMG comment

The amendments to the CFC and FIF rules are primarily base maintenance related. The amendments to the Foreign Superannuation tax rules are aimed at addressing gaps in the legislation that was enacted last year. The clarifications are welcome.

Removal of multiple year tax return filing requirement

The Bill repeals various recent changes to the tax return filing requirements for individuals which were intended to apply from the 2016-17 income year. This is in anticipation of Inland Revenue's Business Transformation ("BT") changes.

KPMG comment

Progress on BT is the main driver for this proposal to reverse recent moves to tighten filing requirements for individuals. The specific measure would have required an individual to request an income statement (Personal Tax Summary) for the previous four years as well as the year of refund. This was to stop non-filers cherry picking refund periods.

Inland Revenue's latest thinking is that this "back end" solution is not required. The focus of BT will be on solving the "front end" problem – the inaccuracy of PAYE deductions, which gives rise to large credits or debits. The "benefits" from more accurate withholding systems are expected to arise from 2019-20.

This proposal (again) reinforces the importance of BT to businesses who employ people and make payments which are, or might be, subject to withholding tax. If a tax return becomes less important for "squaring up" someone's tax liability, this must mean there is more pressure on employers and withholding agents to deduct the right amount of tax.

Increasingly, the expectation is that this will be in "real time". As anyone in the real world knows, this is a difficult standard. It will have implications for the design and operation of existing payroll and deduction systems.

Other changes in the Bill

These include:

- Allowing employers in the same group as a person in the business of lending money to the public (e.g. a bank) to use market rates of interest to calculate FBT on employment-related loans.
- Allowing provisional tax pooling to meet use of money interest ("UOMI") charges on additional tax resulting from an amended assessment or resolution of a tax dispute, from 3 July 2014.
- Ensuring the property transfer rules (e.g. from trusts to beneficiaries or on settlement/transfers of relationship property) work as intended.
- Remedial amendments to the bad debt deductibility rules (e.g. to clarify that the capital limitation does not apply to prevent a bad debt deduction for a loan if the lender has entered into the debt in the normal course of business) and the financial arrangement rules (e.g. to clarify the allocation of financial arrangements income/expenditure when two companies amalgamate).

KPMG comment

We welcome the proposal to allow employers that are part of a wider finance group to use market interest rates for FBT purposes. Presently, a bank that employ its employees through a special purpose group company is not able to use its own market lending rates to benchmark the fringe benefit component on employment related loans. This is because the employing group company is not technically in the business of lending. This is a nonsensical result.

The proposal to allow provisional tax pooling to cover certain UOMI obligations is also a positive step. However, the popularity of (and the need for) tax pooling reflects underlying concerns about the application of the UOMI and penalties regimes, generally, which need to be addressed. Inland Revenue's BT should be used as an opportunity to do so.

Further information

If you would like to discuss the Bill in greater detail, please contact your regular KPMG advisor or:

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