KPMG

TaxMail

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Regular commentary from our experts on topical tax issues

Issue 1

Omnibus tax bill introduced

Snapshot

The Government has released an omnibus Tax Bill. It changes the tax rules for closely-held companies, widens the application of the non-resident withholding tax (NRWT) rules, and implements the recent related-party debt remission (and capitalisation) announcement. For good measure, a number of GST changes and various "remedial" amendments have also been thrown into the mix. The result is a Tax Bill which is nearly 150 pages and more than 200 pages of explanatory material.

Given the sheer volume of change, we refer you to our previous taxmails for the detail of the proposals previously announced. Our focus is on the key changes to those proposals and new items in the Tax Bill.

The Tax Bill contains a number of taxpayer-friendly measures. In particular, we welcome the legislative confirmation that related-party debt remissions and capitalisations will not create adverse tax consequences. Similarly, parts of the close company tax package, such as removing loss limitation restrictions for look through companies will be useful.

However, there is a sting in the tail with the NRWT measures on related-party offshore funding. Although not stated as such, our view is that they represent a further New Zealand response to base erosion and profit shifting (BEPS) concerns.

At nearly 150 pages of draft legislation and over 200 pages of explanatory material, the Tax Bill is a monster read

The challenge for taxpayers will be to digest the sheer volume of change, which ranges from NRWT to debt remissions to GST

As with any Tax Bill there is a mix of taxpayer friendly and less friendly measures

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What are the key measures in the Bill?

Issues that have been previously consulted on

Proposal	What's in the Tax Bill
1. Close company tax changes (refer our taxmail on the original proposals)	
Look Through Company (LTC) entry requirements • Shareholding trusts in LTCs • Maori authority shareholders • Other entry requirements	The current 3 year distribution period for treating beneficiaries of shareholding trusts as look through counted owners of LTCs will remain. Trusts that distribute to charities that have no control or influence over the LTC or trust can still qualify as shareholders in LTCs. Maori authorities that were shareholders in LTCs (or beneficiaries of shareholding trusts in LTCs) before the introduction of the Tax Bill will be grandfathered. The other entry requirements are largely unchanged from the original proposals.
Qualifying companies – continuity of ownership	The Tax Bill confirms that qualifying company status will be lost if shareholder continuity falls below 50%.
"Tainted" capital gains distributed on liquidation	The tainted capital gain rule will only apply if there is at least 85% common ownership when the related party capital gain arises and when the company making the gain is liquidated.
The following original proposals have been included in the Tax Bill largely unchanged: • Removal of the LTC deduction limitation rule. (This will have effect from the 2017-18 income year.) • Modifications to the LTC entry tax calculation. • Clarifying that there is no debt remission income for the LTC shareholder or partner (in a partnership) remitting shareholder or partnership debt. • Allowing companies to opt out of deducting RWT on fully imputed inter-company dividends and to treat cash and non-cash dividends paid concurrently as a single amount for RWT calculation purposes. • Allowing PAYE to be deducted on shareholder-employee salaries.	
2. NRWT and related-party lending (refer our taxmail on the original proposals)	
Application of NRWT instead of Approved Issuer Levy (AIL)	The Tax Bill confirms that NRWT, rather than AIL, will apply to back-to-back loans and loans made by a group of non-residents "acting together". Additionally, AIL can only be applied if the borrowing is with a foreign unrelated party and: • The NZ borrower or foreign lender are financial institutions or widely-held companies; or • The NZ borrower has paid in the previous year, or is expected to pay (in the current or next year), interest of at least NZ$500,000 to non-residents. Inland Revenue can also issue determinations for certain categories of borrowers, foreign lenders or transactions to be eligible for AIL.
Removal of the offshore and onshore branch exemptions from NRWT for banks	New Zealand banking groups can pay AIL, instead of NRWT, on interest payments to associated non-resident lenders.
Application date of the branch lending proposals	For existing branch funding arrangements, limited transitional rules (of between 2 and 5 years depending on the type of arrangement) will apply.
The original proposal to apply NRWT to a financial arrangements definition of "income" (rather than interest paid), for related-party cross-border financing arrangements, with the tax liability also triggered under those rules, has been included in the Tax Bill largely unchanged.	
3. Related-party debt remission (refer our taxmail on the original proposals)	
Core remission rule	Shareholder (or partnership) debt will be deemed to have been repaid where the debt is remitted by the shareholder (or partners). This will not give rise to remission income for the debtor, including where the debt is capitalised in identical circumstances. (Under the latter there is no scope for Inland Revenue to assert a tax avoidance purpose.)

Remission by associates of the creditor	The core rule would also apply to debt remissions by a member of the same wholly-owned group as the creditor or an associated individual who has "natural love and affection" for the creditor (e.g. a spouse, parent or sibling).
Taxable dividend to the creditor	The Tax Bill confirms that a dividend will arise to a creditor shareholder, on remission, except where the debtor and creditor are in the same wholly-owned group.
No bad debt deduction for the creditor	The Tax Bill confirms that a bad debt deduction will not be available for the creditor, if these rules apply.
Where a debt guarantee payment is made	A guarantor in the same wholly-owned group as the debtor will be deemed to acquire the debt to the extent any payment is made under the guarantee. An amount paid to the guarantor above the debt's carrying value will be taxable (and deductible to the debtor). This is modelled on the current debt parking rules.
4. Loss grouping and imputation credits (refer our taxmail on the original proposals)	
Companies can transfer imputation credits to another company in a commonly owned group as part of loss grouping	The company transferring the imputation credits to the company using the loss ("profit co") can be either the company that transfers the loss ("loss co") or a group company that owns at least 66% of profit co. The Tax Bill also contains detailed rules governing the timing of, eligibility for, and limitations on imputation credit transfers and extends the imputation credit shopping rules.
5. GST amendments (refer our taxmail on the original proposals)	
Recoverability of GST on capital raising costs	The Tax Bill confirms that, from 1 April 2017, the issue or renewal of debt or equity securities and payments under such securities will be treated as zero-rated financial services to the extent the funds raised are used to make taxable supplies. (Apportionment will be required if the funds are used for non-taxable activities.)
Taxable and exempt activity input GST apportionment calculations	The Tax Bill confirms that alternative apportionment methods will be allowed if agreed with Inland Revenue by an individual taxpayer (for businesses with turnover greater than $24m) or an industry association or body. While not legislated, the Tax Bill Commentary outlines a list of factors that an agreed apportionment method must take into account.
The other GST amendments included in the Tax Bill are largely unchanged from the original proposals.	

New issues

Other issues in the Tax Bill include:

- New rules for deductibility and timing of aircraft overhaul expenses.
- A legislative "clarification" that New Zealand's Double Tax Agreements (DTAs) do not override the application of the general anti-avoidance rule (in section BG 1) to a tax advantage arising under a DTA.
- Clarifying that the 4 year time bar applies to ancillary taxes (such as NRWT) and AIL.
- Remedial amendments to:
  - the tax pooling and life insurance business taxation rules.
  - prevent imputation credits attached to taxable bonus issues creating available subscribed capital and to create a cost base for bonus shares on their disposal (being the dividend amount, excluding imputation credits and any withholding tax).
  - limit income tax refunds to the imputation balance at the end of the previous year, if the current year return is not due to be filed due to an extension of time.

Our view

Range and volume of change

The Tax Bill is a monster read. The challenge for taxpayers will be to digest the range and volume of change.

The concern with omnibus Tax Bills of this scope and size is the potential for items to be overlooked by submitters. The devil inevitably does tend to be in the detail, which makes a proper review difficult.

The Tax Bill proposes to correct a number of policy problems, for example, shareholder debt capitalisations. Here, it is acknowledged that the correct policy is not to tax. However, the Commissioner's conclusion that this is tax avoidance was due to the lack of a clear policy statement. The different parts of this Tax Bill suggest that an equivalent problem will arise from these measures.

However, we acknowledge the sheer volume of continuing changes to the tax system also makes it difficult to manage the size of tax legislation. In many cases, the Tax Bill deals with issues that cannot, and should not, be left unaddressed.

The good…

There are a number of positive measures in the Tax Bill.

We finally have draft legislation confirming that related party debt remissions (and by extension debt capitalisations) will not create adverse tax consequences. The Commissioner's 2015 tax avoidance conclusion on debt capitalisations created the concern that past and future capitalisations could have a tax cost. Once enacted, the amendment will have retrospective effect to 2006-07. However, taxpayers will not be able to re-open past returns to treat historic related-party debt remissions as non-taxable.

A number of the close company tax changes are useful. These include removing the restriction on LTC deductible losses to capital invested in the company and ensuring that fewer capital gains made with associates are tainted (i.e. taxable on liquidation). The 85% or greater common shareholding test for tainted capital gains is an improvement. The original proposal was to remove tainting on disposals to non-corporate associates. However, we remain unconvinced of the rationale for having any tainting rule when New Zealand does not have a general capital gains tax.

Officials (and Government) appear to have also listened to concerns raised around the tightening of the LTC entry criteria. The Tax Bill contains more pragmatic rules for trust shareholders in LTCs (e.g. by allowing charities to remain beneficiaries of such trusts without disqualifying the LTC status).

Other positive changes in the Tax Bill include allowing GST recovery on capital raising costs and the imputation credit and loss grouping proposal. The GST component of capital raising costs can be significant and its non-recoverability is an additional cost of capital. The proposal to allow companies (that would otherwise have an imputation shortfall due to use of group loss offsets) to fully impute their distributions is aimed at reducing tax leakage for minority shareholders. It will have limited application, however, due to the narrow scope of the rules.

Also worth noting is the legislative clarification that the time bar for reopening past assessments applies where AIL has been incorrectly deducted instead of NRWT. Inland Revenue has previously argued that the time bar does not apply when AIL was erroneously deducted instead of NRWT, as a NRWT return was not filed. This measure ensures that the filing of an AIL return will trigger the time bar rules for AIL (and NRWT) purposes.

… and the bad

Less welcome will be the changes to the withholding tax rules for cross-border related-party funding.

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The onshore (and offshore) branch exemptions for bank funding have been replaced with the 2% AIL for banks and other financial institutions. While an improvement from the original proposal to apply 10% NRWT, this still represents an additional tax cost to foreign lenders.

Officials' argument in support of the NRWT changes is that the overall impact is likely to be minimal. This is based on the forecast additional revenue from the total NRWT package being around $57 million per annum. This begs the question why significant compliance costs are being imposed on New Zealand borrowers, from changing their systems and funding arrangements, if the NRWT at stake is negligible.

This is also a concern with the proposal to limit AIL. The original proposal was to limit AIL to funding from unrelated foreign financial institutions or where there were at least 10 unrelated foreign borrowers. (This was to "improve the integrity of the rules".) The latter meant that private debt placements, for example, with less than 10 unrelated creditors would be subject to 10% NRWT, significantly increasing the cost of funds for NZ business.

The proposal in the Tax Bill is a slight improvement. AIL will still be available for widely-held borrowers and lenders or where the total interest payable to non-residents is NZ$500,000 or more per annum. While this should help larger NZ businesses, it may narrow the range of offshore funding sources for small to medium sized-businesses due to the additional tax cost. Further, the exclusion from AIL will apply from 1 April 2017 to any debt securities registered on or after that date and for all securities from 1 April 2018. KPMG strongly believe that the better approach is for Inland Revenue to audit and prosecute cases where there is NRWT avoidance, rather than a blanket blunt rule to limit when taxpayers can apply AIL.

While Officials may argue otherwise, we believe these proposals (and the proposed section BG 1 override of NZ's DTAs) fit closely with the BEPS project. Officials note that these NRWT issues have been well known. In fact, Officials previously consulted on changes to the NRWT regime in 2009, but no changes were made. The current proposals are aligned to the OECD Action 4 BEPS recommendations. The BEPS project has given Officials the cover they did not have previously for recommending the changes.

For further information

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