

## NEWSLETTER



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*Our office will close 12 pm on 20 December and reopen in the New Year on 13 January 2020. Thank you for all your support this year. From the team @ Business & Tax Centre.*

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### Court case – tax avoidance arrangement

Two recent (connected) cases at the Taxation Review Authority (TRA) demonstrate that unnecessarily complex



transactions can raise a red flag for IRD.

Both cases related to a taxpayer referred to as Mr Brown, who acquired a 2/3 interest in a joint venture known as the NPN Partnership (NPN) back in 1981. NPN held several residential property investments, of which a 2/3 share was transferred into one of Mr Brown's family trusts.

Over a period spanning 20 plus years, the income rights to the rental income derived by NPN were sold from one of Mr Brown's family trusts to another on three separate occasions. Although each transaction was slightly different, broadly, on each occasion the trust acquiring the income rights funded the purchase by way of vendor loan, with the interest capitalised and not payable until the expiry of the loan.

Close to the end date of each loan, the trust would sell the income rights to a newly settled family trust for a price equivalent to the outstanding loan with accumulated interest. In effect, each of these sales from trust to trust created a new loan. On each occasion, the new loan gave rise to an interest expense which the trust claimed as tax deductible, offsetting the rental income derived from NPN such that no tax was paid.

The Commissioner contended that the arrangements constituted a tax avoidance arrangement pursuant to BG 1 of the Income Tax Act, and sought to deny the interest

deductions whilst reconstructing the income derived by NPN onto Mr Brown. The Commissioner contended that during the time the income rights were held in trust, the rental income was used by Mr Brown for his personal and family expenses. The taxpayer contended that the transactions were all standard commercial transactions, and there was no artificiality in the trusts obtaining the interest deductions. However, the TRA supported the Commissioner, ruling that the transactions were driven with a tax motive in mind, with no commercial reality, given that the loans resulted in no economic cost to the trusts. The structure

was artificial and contrived.

In sentencing, the TRA allowed IRD to impose re-assessments dating back to 2001, as they considered Mr Brown's tax returns to be wilfully misleading. As a further sting in the tail, it was deemed that the Trustees of the family trusts had failed to meet their tax obligations, hence the income was taxable at the 'non-complying trust rate' of 45%.

A good reminder that whilst all taxpayers are entitled to arrange their affairs in a tax efficient manner, tax should not be the main motive for a transaction with no commercial substance.

## Property sales - business premises exclusion

The land taxing provisions deem certain sales of land to be subject to income tax, subject to a limited number of exceptions. One such exception is for 'business premises'. However, the circumstances in which it applies can be a grey area. Hence, two recent 'Questions We've Been Asked' (QWBA) issued by Inland Revenue (IRD) are welcome.



The treatment of business premises is different depending on the situation.

The first situation is the bright-line provision that taxes the sale of residential property sold within five years of acquisition. For the bright-line test to apply, the land must not have been used 'predominantly as business premises'; irrespective of whether there is a dwelling on the premises. 'Predominantly' has both a time and space element to it. Hence, the land must have been used as a business premises for more than 50% of the ownership period, and more than 50% of the land area must have been used as business premises.

The test does not require the landowner to occupy the land for the purpose of their own business – the test can be met where the land is let and used as the business premises of a tenant.

Bare land (zoned residential) can also be classified as business premises where it is used for business activity. The exclusion operates on an all or nothing basis. Providing the land is used 'predominantly' for business premises, the sale of land will not be taxable pursuant to the bright-line test. However, if the land was only used, say 40% of the time as

business premises, the test will fail and 100% of the profit on disposal will be subject to tax.

The second situation is the use of the business premises exclusion contained in section CB 19, which overrides the application of the broader land

taxing provisions (e.g. the dealer, developer or builder provisions). When using this provision, the business exclusion can be claimed if the land is the premises of a business and the person acquired or erected, and occupied the premises to carry on a substantial business from them. This requires the land to have been used in the business of the owner; if however, the land was let and used as business premises of the tenant, the exclusion cannot be used.

It also requires the business activity to be "substantial", which comes down to the application of case law. Although this is more stringent than in the first situation above, this exclusion can apply to part of a sale. For example, the sale of 100% of a mixed use commercial and residential property could be taxed under the brightline if the residential use area is larger than the commercial area, i.e. it is not predominantly business premises. However, in the second situation, the CB 19 exclusion can shelter the profit on the commercial portion of the building.

Overall, these recent QWBA publications provide clarity on the application of the business premises exclusion to different scenarios, and contain some good examples, so they are worth a read if you think they may apply.

## Generation Z – our future workforce

The rise of Generation Z ('Gen Z') is imminent in today's workforce. Comprised of those born between mid-1990s and early-2000s, Gen Z has grown up in a world with technology at their fingertips. Common traits include: confidence, desire to succeed, thriving on recognition, being adaptable and tech-savvy. However, their most valuable aspect is they represent an organisation's future.



Fast forward 10 years from now – baby boomers will be retired and employers will have no choice but to recruit an increasing number of Gen Z employees. As Gen Z members are currently young, they are perhaps not a priority when it comes to recruitment planning. However, it is crucial employers learn to understand this generation and how to attract, recruit and retain them.

If Gen Z members are not being challenged, recognised or rewarded for their efforts, they will have no hesitation to search for opportunity elsewhere. Today, it is increasingly common for employees to change jobs after spending only months with their employer. It is clear that the fierce, unparalleled loyalty that was once displayed by previous generations will not be as prevalent in the future. Being adaptable and tech savvy also means Gen Z will demand remote working and flexible working – such "perks" will become expected, rather than incentives.

To attract Gen Z into their organisations, employers should be aware that the approach to

job searching is significantly different to the traditional methods. Often, Gen Z begin their job search on the organisation's website – looking for the organisation's culture to impress them. They then head to social media to learn more. Hence, organisations need to get creative with different social platforms and use them to reach out to potential candidates.

Organisations should also assess whether existing recruitment processes remain appropriate. For example, it is currently commonplace for psychometric testing, essay writing, and even written case studies to be requested before interview stage. An absence of face-to-face communication can make Gen Z candidates feel like just a number. Understandably, this lack of human interaction does not initiate feelings of loyalty. Extensive recruitment processes can also dissuade Gen Z workers from applying at all, meaning employers are missing out on potential candidates. To combat this, organisations should prioritise the key aspects of the recruitment process, and eliminate any unnecessary stages.

Ultimately, whether an organisation can tailor their recruitment plan for Gen Z will depend on its individual circumstances. Nonetheless, it is important for employers to understand this generation and how to best attract, recruit and retain them.

## Is a Trust beneficiary also a settlor?

Family Trusts are used widely in New Zealand; often being viewed as beneficial for asset protection and to keep assets in the family for future generations. A reason for their popularity has been the relative simplicity of the legal and tax regime.

However, the rules are evolving. In addition to the widely publicised re-write of the Trust Act, Inland Revenue (IRD) has issued a recent clarification in relation to whom is classified as 'settlor' of a Trust.

The settlor is generally the individual that transfers assets into the trust. At face value, identifying the settlor is an easy task, as they are often named on the trust deed. However,

confusion can creep in when other individuals inadvertently transfer value to a trust.



Section HC 27 Income Tax Act 2007 states that a settlor is a person who "transfers value to the trust, for the benefit of the trust, or on terms of the trust". This definition has long been the source of debate when applied to a relatively common scenario. Trustees commonly declare distributions to a beneficiary, but the beneficiary does not draw the cash out thereby giving rise to an interest free loan to the trust. Is this sufficient to be a 'transfer of value' that deems the beneficiary to also be a settlor of the trust?

IRD have recently provided definitive clarification on the matter. A legislative amendment to HC 27

has been made and a 'Commissioner's Operational Position' has been issued. A beneficiary will not become settlor if either:

- a. the amount owing to them from the trust at the end of the income year is \$25,000 or less; or
- b. the trust pays interest to the beneficiary at a rate equal to or greater than the prescribed IRD interest rate.

Hence, if a beneficiary leaves over \$25,000 'on call' in the trust, and does not receive sufficient interest, they will become a 'settlor'. This new rule becomes effective from 1 April 2020, and does not have retrospective effect.

Why does this matter? A person becoming settlor of a trust can have an array of unintended tax consequences. For example, two trusts are

'associated' where they have common settlors. This has wide tax implications if one trust deals or develops land, then the 'other' trust could inadvertently become subject to tax on the sale of its land.

Furthermore, the tax position of a trust is based on the tax residency of the settlor. If a deemed settlor becomes non-resident for tax purposes, this could unintentionally result in the trust being deemed a foreign trust, bringing an array of tax complexity and additional compliance obligations. For the individual themselves, there can be consequences for their social security status, student loans etc.

Hence, trustees and beneficiaries alike need to pay heed to these new rules to avoid pitfalls.

## Snippets

### Wacky business ideas



Ever dreamt of being your own boss? Well, millions of people have turned that dream into a reality and some even claim it's easy! Recent studies conducted by the Global Entrepreneurship Monitor

reveal that 40% of respondents thought starting a business was easy and 46% thought there were plenty of opportunities to start a business. Based on some of the strange, yet successful, business ideas out there, they might just be right.

Have you ever had the urge to send someone a message on a potato? Well now you can! Potato Parcel lets you send a potato with a personalised message written on it. They've already sold over 70,000 potatoes! If gifting a vegetable isn't quite your style, perhaps a pet rock is more appropriate? Entrepreneur Gary Dahl launched the Pet Rock back in the 1970s and despite the craze only lasting about six months, it was still enough to make Dahl a millionaire.

Another common sector for new businesses is the fitness industry. New exercise fads are constantly emerging; one of the more unusual ideas are "rage rooms". Originating in Tokyo, the rooms are designed to provide patrons with a chance to hurl cups or plates against concrete slabs in an effort to relieve stress. Today, they've spread all over the world with more than 100 scattered across the USA alone.

So, get your thinking cap on, the more unusual the idea, the better!

### Times are changing

Developments in electronic payment methods and improved ease of online payments from your smartphone or tablet, means processing cheque payments has become a rather laborious task.



However old habits die hard, and a significant amount of people continue to use cheques – Inland Revenue (IRD) alone received more than 430,000 cheques in the year ended June 2019. Although this is a large number, it represents just 5% of all payments to IRD for the same period, and over time reflects a 20% year on year decrease in the proportion of cheque payments.

IRD and ACC have announced that from March 2020 they will no longer accept payment by cheque; other than for customers that are unable to use alternative payment options.

Besides internet banking, both IRD and ACC accept payment by debit/credit card over the phone, via direct debits, and cash or eftpos payments at Westpac Bank branches. In addition, IRD payments can be made through MyIR, and for ACC through your MyACC for Business accounts. Doing away with cheques will impact a range of taxpayers/businesses; however, it is a reflection of the digital world we live in today and a definitive move away from the paper based era of payments.

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