

## Winter Blues

*All the world's a stage, and all the men and women merely players... and one man in his time plays many parts...*

Shakespeare, circa 1600, I have always loved that quote. In light of this week's US/North Korean summit, perhaps it is most apt. Playing one of my many parts, here is a compilation of articles that I hope you will enjoy.

## Interest Limitation Rule Changes...

The anti 'base erosion and profit shift' (otherwise known as BEPS) measures are soon to be implemented; officials are committed to introducing these measures into law by 1 July 2018, their target date.

One of the measures is the interest limitation rule on related-party debt. This rule aims to limit artificially high interest deductions on related-party debt between a New Zealand subsidiary and an offshore parent. Historically, New Zealand limited the amount of related-party debt through a combination of thin capitalisation rules with transfer pricing rules. There has been a concern that transfer pricing rules are too subjective and too hard to police, overall not being as effective at keeping interest deductions in New Zealand at an appropriate level.

To give you a bit of context, use of related-party debt to fund New Zealand operations is one of the simplest BEPS strategies. Interest payments are generally deductible in New Zealand. A cross border loan between an offshore parent and a New Zealand borrowing subsidiary is coupled with a high interest rate. That high interest rate will reduce the New Zealand subsidiary's assessable income and therefore taxes payable in New Zealand. The BEPS measure targets this type of arrangement.

## June 2018 – Tax Edition

### Issue 26

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#### Briefly – Special Interest/Sport

- Sir Richard Hadlee battling bowel cancer
- Simon Mannering retires from Kiwis
- Phil Mickelson about to start his 27<sup>th</sup> US open; Dustin Johnson retains No. 1
- Nadal wins 11<sup>th</sup> title at French Open
- US agrees to no further military exercises in South Korea in exchange for North's denuclearisation

#### Briefly – Law

- Allan Hawkins (of Equitcorp fame) owned finance companies (Budget Loans and Evolution Finance), fined for breaching Fair Trading Act
- Proposal to repeal Three Strikes Law not supported by NZ First, shelved
- AML/CFT: 1 July implementation date draws nearer
- OIO residential land amendments delayed
- Exposure draft of new Listing Rules released
- Alleged price fixing proceedings commenced against Nelson pharmacists

The rule would restrict the credit rating of New Zealand borrowers that were determined to be high risk of BEPS. In turn, that credit rating would help determine the appropriate amount of interest that should be paid by the borrower. The credit rating will depend on a number of factors and could be, in limited circumstances, the borrower's own credit rating for long-term unsecured debt; or the higher of BBB- and the rating that would be given if the borrower had a debt ratio of less than 40%; or the higher of the borrower's credit rating and the highest credit rating in the borrower's worldwide group minus two notches (provided the group has a rating of BBB+ or higher, otherwise it will be one notch).

Once the credit rating is established, further features must be disregarded or adjusted when pricing the debt including features that: defer interest payments for a period of more than 12 months; exclude the exercise of a lender's usual rights to enforce the payment of interest or principal; provide that the loan term is more than 5 years.

To reduce compliance costs, a de minimis applies to exempt the taxpayer from these rules if the cross-border related-party loans are less than \$10 million. Where this exception applies, ordinary transfer pricing rules will apply.

Specific rules will apply to taxpayers who are insurers or in the business of lending.

The proposed bill also contains amendments to New Zealand's thin capitalisation rules. The thin capitalisation rules limit the amount of debt a foreign-owned subsidiary can claim deductions for interest paid. Interest deductions are denied to the extent that the debt exceeds 60% of the subsidiary assets.

Currently debt percentages are the comparison between an entity's debt relative to its gross assets. The main issue is the current treatment of non-debt liabilities. These liabilities allow companies to have higher levels of debt and therefore higher interest deductions relative to the capital invested in a company by its shareholders. The bill proposes to change this so that debt percentages are based on the entity's assets net of its non-debt liabilities.

### **Bank Account Requirements for Offshore Persons...**

A cause of frustration in recent years has been obstacles in opening an IRD number for offshore

persons. Practitioners have been thwarted by a chicken and egg situation; it has not been possible to obtain an IRD number without a NZ bank account and it has not been possible to open a NZ bank account without an IRD number.

A recent amendment overcomes this problem. The amendment is in the form of newly introduced section 55 B of the Tax Administration Act 1994 which provides the Commissioner with a discretion to allocate an IRD number to an offshore person who does not have a NZ bank account if she is satisfied with their identity and background. This amendment took effect on 29 March 2018.

Guidance on what is needed to satisfy the Commissioner of an offshore person's identity and background is published on Inland Revenue's website. The following published example is illustrative.

A company incorporated in Singapore wants to open a branch in New Zealand. It is listed on the stock exchange, and it has more than 5 shareholders. The company needs an IRD number, to pay its income tax. The company will need to provide the following documents:

- Certified copy of the Certificate of Incorporation;
- Details of the stock exchange listing;
- Certified passport photo page for at least one executive office holder or director;
- Certified proof of residential address for at least one executive office holder or director;
- Names, addresses and TIN numbers of all directors; and
- A bank account statement with the company's bank account details in Singapore (as New Zealand has a Double Tax Agreement with Singapore, and both countries have also agreed to automatic exchange of financial account information).

Other exemptions to the bank account requirement exist for non-resident suppliers of goods under the GST Act and customer due diligence on them has been conducted by a reporting entity under the Anti-Money Laundering legislation.

## Trustee Capacity – Corporate Trustee...

Where a trust has a corporate trustee, are the shareholders of the trustee company associated with the trust? Take for example a corporate trustee company owned by a solicitor which is trustee for multiple trusts. You can see the problem with the associated person rules if the solicitor is treated as having an interest in the trust; if so, he or she will be treated as having an interest in all the trusts for which his or her trustee company is the corporate trustee. Potentially this could associate, unknowingly, multiple unrelated trusts. Indeed this was a real concern following two High Court cases (*Concepts 124 Limited v CIR* and *Staithe Drive Development v CIR*) which confirmed that the measurement of ownership rules in a trust with a corporate trustee focused on the legal owner of the shares in the trustee company.

Legislative amendment corrects this. New section YA5 of the Income Tax Act does so by providing that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal capacity.

An exception applies to the asset stripping of companies. Section HD15 still applies to a company acting in its capacity as trustee. That section authorises the Commissioner to recover income tax from the directors and shareholders of a company who have entered into an arrangement or transaction to deplete the company's assets so that it is unable to satisfy its tax liabilities. Without this exception, a corporate trustee could enter into an arrangement to deplete its assets so that it is unable to satisfy its tax liabilities and the Commissioner would have no means of recovering any of the corporate trustee's unpaid income tax from its directors or shareholders.

## Converting a LTC to an Ordinary Company...

Shareholder loans to an insolvent company have long been problematic, the worry being forgiveness of debt income for the debtor company on remission of the loan. In the case of a look through company (LTC) the tax liability fell on the shareholders.

Amendments were made last year to ensure that a LTC shareholder or a partner in a partnership do not have debt-remission income, when they lend money to the LTC or partnership which they subsequently remit. This was termed "self-remission" by which the

shareholder or partner gets a deduction equivalent to the income arising for them.

When a LTC converts to an ordinary company, the shareholders in the LTC are treated as having disposed of their property to a third party, triggering a base price adjustment for those shareholders and resulting in a tax liability for them where the LTC is insolvent.

This result was unintended when the "self remission" problem was remedied last year. This result has now been corrected. That has been done by introducing new sections EW 29(14) and EW 47B to provide "self remission" treatment when there is income from a deemed disposal on a liquidation or similar event that arises due to loans from a shareholder to a LTC.

## RWT on Non-Cash Dividends...

Non-cash dividends derived by a New Zealand resident individual from a foreign company are not subject to resident withholding tax (RWT). That has not historically been the result when the dividend is received by an intermediary on behalf of the New Zealand resident individual and later distributed to that individual. RWT has applied in that situation.

A recent amendment changes that result. Under the amendment, a New Zealand resident intermediary will not be required to account for RWT on a distribution of a non-cash dividend derived from a foreign company provided that:

- The non-cash dividend is distributed to a New Zealand resident individual; and
- The distribution of the dividend occurs in the same income year that the intermediary derives the non-cash dividend.

This will be the result for dividends distributed during the 2017-2018 and later income years.

## John Russell Dies...

Mr Russell is famous within the tax fraternity for having implemented numerous tax schemes, endlessly battling the IRD in one court case after another and being indebted to IRD for almost \$500m (mostly penalties and interest). He died last week.

An example of a scheme implemented by him and described by the Court as a blatant tax avoidance scheme follows.

Shareholders in profit company sell their shares to a company that has tax losses. The sale price for the shares remains as a vendor loan.

The profit company paid administration fees to the loss company which in turn applied the amounts received (less some retained for itself) in paying the vendor loan. Upon the loan being repaid, ownership of the shares in the profit company reverted to the original shareholders pursuant to call options in their favour.

Looks like, smells like, is and always was tax avoidance.

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