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Global Tax Alert

New Zealand introduces new omnibus tax Bill

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Executive summary

On 4 June 2020, the New Zealand Government introduced the *Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill* (the Bill) into Parliament.

The Bill proposes a number of changes to New Zealand's tax rules which will be of differing relevance to taxpayers. Several of the changes were signaled by the Government prior to the COVID-19 pandemic, including changes to the tax deductibility of feasibility expenditure, changes to the taxation of certain land sales, the introduction of purchase price allocation rules and changes to the tax treatment of certain leases.

The changes proposed in the Bill will be subject to public consultation with submissions due in the coming months. These changes are expected to be enacted in early 2021.

This Alert summarizes the key changes proposed by the Bill.

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Detailed discussion

Feasibility expenditure deductibility

Following a court ruling in 2016, certain feasibility costs that may have previously been considered tax deductible as revenue expenditure or depreciable over time for tax purposes, could no longer be deducted or depreciated in New Zealand. The Government has for some time recognized that a law change was needed in this area to alleviate the economic distortion caused by the resulting tax treatment which discouraged investment.

The Bill proposes to reverse the court ruling to a degree, by allowing businesses to deduct expenditure related to completing, creating or acquiring assets where progress on the asset is abandoned. Tax deductions for qualifying expenditure can be spread in equal proportions over five years from the income year in which progress on the asset is abandoned. Claw-backs of deductions will apply if abandoned assets are later completed.

The proposed rules also introduce a new immediate tax deduction *de minimis* for business expenditure incurred in developing assets that in total does not exceed NZ$10,000 (US$6,472) in an income year. There is no requirement that the asset be abandoned for the expenditure to qualify for this immediate tax deduction, although other qualifying criteria apply.

While the change is welcome, New Zealand's tax settings continue to discourage investment if invested funds result in non-deductible and non-depreciable expenditure in cases not covered by the new amendments. Further, the changes are not backdated to the 2016 court ruling but are proposed to apply for qualifying expenditure incurred in the 2020–21 and later income years. This delay in application, while understandable from a revenue management perspective, is unfortunate for such expenditure undertaken in the interim period.

Changes to taxation of certain land sales

While New Zealand does not have a comprehensive capital gains tax, several rules tax the net income arising from the disposal of land in various circumstances. For example, gains from the sale of land in New Zealand can be taxed if the land was:

- Acquired with an intention or purpose of disposal;
- Acquired and disposed of within five years; or
- Acquired for the purpose of a business relating to dealing in land, land development or subdivision.

However, there are a number of exclusions which apply to limit these rules. The main exclusions relate to gains made on the sale of land used predominantly for a dwelling that was the person's main home or residence, or as a business premises.

Restrictions on the ability to use these exclusions apply in cases where there is a "regular pattern" of buying and selling land. Officials are concerned that the current "regular pattern" restrictions allow taxpayers who habitually buy and sell land to structure around the rules. This may be achieved by using different people or entities to carry out separate transactions, or by varying what is done to the land in each transaction such that there is no "regular pattern." The amendments proposed in the Bill expand the restrictions to apply to "regular patterns" of buying and selling land by a group of persons acting together.

The proposed amendments would apply to land acquired after the date of enactment. Importantly, however, land acquired before the application date would be able to be considered in determining whether a group of persons have a "regular pattern."

Purchase price allocation rules

In a sale of two or more assets with different tax treatments (for example trading stock, plant and machinery, and goodwill), the parties to the transaction must allocate the total transaction price between the assets for income tax purposes. The allocation determines the vendor's tax liability from the sale, and the purchaser's cost base for claiming tax deductions over time.

Currently the vendor and purchaser are able to adopt different allocations of the total price between the various assets for income tax purposes, which can result in asymmetric tax consequences arising for the parties to the same transaction. Officials are concerned that this asymmetric treatment results in lost tax revenue as parties seek to adopt price allocations that minimize their own tax liabilities.

The Bill proposes to tighten the rules that govern how parties to a sale of assets allocate the total price between the assets for income tax purposes. Under the proposed new rules, the vendor will generally determine the allocation in cases where the parties do not agree an allocation. The Commissioner of Inland Revenue may challenge an allocation if she considers it does not reflect market values, regardless of whether the allocation is agreed between the parties or made by the vendor. There are two proposed *de minimis* thresholds that apply in specified circumstances.

The amendments would apply to agreements for the disposal and acquisition of property entered into on or after 1 April 2021.

Income tax treatment of certain leases

The Bill includes proposed amendments to provide lessees with certain leases accounted for under *New Zealand Equivalent to International Financial Reporting Standard 16 Leases* (NZ IFRS 16) with a one-off optional choice to more closely follow their accounting treatment for tax purposes. The proposed tax changes would apply for balance dates starting on or after 1 January 2019, to align with the application date of NZ IFRS 16.

The technical details of this proposed change require careful consideration and taxpayers subject to New Zealand's thin capitalization rules will need to consider the impact of the changes on their thin capitalization calculations.

GST on outbound mobile roaming services

Proposed amendments seek to align New Zealand's Goods and Services Tax (GST) settings for outbound mobile roaming services with the OECD[1] approach.

The amendments would result in outbound mobile roaming services used by a person with a New Zealand mobile device while they are outside New Zealand becoming subject to New Zealand GST at the standard rate of 15%. Outbound mobile roaming services are currently either zero-rated or not subject to GST in New Zealand.

The change would apply from 1 April 2021.

Next steps

The Bill is expected to progress through Parliament following the standard process, including a round of public submissions on the proposals. The Bill is likely to be enacted sometime before 31 March 2021.

Endnote

1. Organisation for Economic Co-operation and Development.

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