Limited Partnerships

Initially envisioned to be the preferred investment vehicle for foreign venture capital investors, the Limited Partnership (LP) was brought to life in NZ with the enactment of the Limited Partnerships Act 2008. LPs have now evolved into the preferred business vehicle for many, who benefit from the limited liability of a company whilst acquiring a look–through entity for tax purposes.

The LP structure requires both a limited partner and a ‘general partner’, with the general partner being responsible for the management of the entity. The regime works by requiring that a limited partner must not take part in the management of the LP; otherwise they lose their limited liability protection.

Although the LP itself is a separate legal entity, for tax purposes LPs are treated the same as a ‘standard partnership’. Essentially, the partners are deemed to derive the income, incur the expenditure, carry on the activity, and hold the assets of the partnership, in proportion to their partnership share.

Accordingly, the partners are allocated their share of the partnership income on a pre-tax basis which is then taxed at their respective marginal tax rates. This provides a material advantage to low tax rate entities such as Maori Authorities and charities who might partner up with standard taxpaying entities such as companies that are taxed at 28%. It also allows partners to combine their own expenditure, such as interest deductions, with their allocation of partnership income to have the net result taxed as a single sum. If losses are incurred by the partnership they will also flow out to the respective partners to be offset against other income and carried forward; which is not as easy to accomplish under a standard corporate structure.

On the downside, because the partners in a LP are deemed to own the assets of the partnership in proportion to their partnership share, a percentage change in the ownership of an LP will give rise to a proportionate disposal of the assets. This can give rise to complex calculations and issues when changes in ownership occur. By comparison, a partial change in shareholding in a company is a standard...
transaction with few tax consequences for the company.

Similar advantages can be offered through the Look Through Company (LTC) regime, which share common attributes with LPs – they both offer legal protection in the form of limited liability and are ‘look through’ for tax purposes.

However, LTCs need to comply with strict criteria, such as a limit on the number of ‘owners’. The criteria to remain an LTC can be inadvertently breached without realising it, resulting in the loss of LTC status. Limited partnerships are one of the newest entity types for the New Zealand business environment, and they are rising in popularity. In specific situations, they do offer advantages compared to a generic company. However, for the purpose of more vanilla investments and business ventures, a standard company is still likely to be the better option. Before using a LP ensure there is a specific and material advantage in doing so.

**Proof of intention**

The sale and purchase of residential property is an area of focus for IRD Investigators as a result of the ongoing investment in the Property Compliance Programme. A Taxation Review Authority (‘TRA’) case heard in May 2017, serves as a timely reminder for all property owners to remain aware of the tax implications that can arise from residential property sales. The case involved the purchase and eventual sale of a family home by a son who had previously been involved with other property investments. A key criterion for determining the tax status of a property transaction rests on whether the property was purchased with the purpose or intention of resale. The intention of the taxpayer is determined subjectively at the date the property is acquired.

There are instances where taxpayers have tried to satisfy this subjective test by embellishing their future intentions to support a more desirable tax outcome. Hence, it is common to place some weight on any documentation that might also refer to a taxpayer’s future plans for a property.

In this particular case, a substantial amount of weight was placed on a diary note recorded by the taxpayer’s bank officer, accompanying the loan approval request for the property. The note recorded that the taxpayer had committed to the purchase of the property because his parents were no longer financially able to complete renovations themselves, and that he would sell the property once the renovations were completed, in order to release funds needed for his other property developments.

Due to the diary note and the taxpayer’s history of buying and selling property, the IRD sought to tax the sale of the property. But the taxpayer argued that the file note was not a true account of his intentions. He told the TRA that the bank officer was a close friend of his, a friendship that had been built over years of loan applications and property investments. This had resulted in the bank officer recording a note not of a conversation, but of a mistaken assumption about the taxpayer’s intention to resell his parent’s home.

The taxpayer asserted his true intention was to assist his parents while they were experiencing a period of financial difficulty, safeguarding the family home for the long term. This alternate set of facts was further aided by the form of the bank officer’s note – it did not refer to a specific conversation, but was written as part of the loan approval request, containing information determined relevant by the bank officer.

The process for a case to reach the TRA is lengthy and involves a significant number of steps for both IRD and the taxpayer, so IRD often only reach this point if they consider themselves to have a high chance of success. With this in mind, it must have come with considerable relief to the taxpayer when the TRA ruled in his favour, concluding that the evidence showed he did not purchase the property with the intention of resale.

The case is interesting because the taxpayer went through what would have been a difficult and stressful Investigation and then ‘Disputes Process’, due to a statement that he didn’t make and likely didn’t know existed. The lesson here is that if a property is not being purchased with a purpose or intention of resale, it could be a good idea to state that on the record through the acquisition process, rather than simply relying on that being implicit.
Budget 2017

Budget 2017 presented a broad range of small yet smart changes that target working families and low income earners. From a tax perspective, the key changes are predominantly to the income tax thresholds, working for families’ package and the independent earner tax credit.

All taxpayers will benefit from the tax cuts, and it is hoped that as consumers spending capacity increases, we will see a boost in the consumer economy as a direct consequence of the tax cuts.

Income tax thresholds

The income tax thresholds are set to change from April 2018 for the first time since 2010, with the lowest 10.5% bracket increasing from $14,000 to $22,000, and the next bracket of 17.5% moving from $48,000 to $52,000.

Over time inflation has pushed wages and salaries into higher tax brackets, resulting in the Government benefiting from a higher proportion of income being taxed. These new income tax thresholds seek to rectify this bracket creep and in that sense, simply reverses effective increases in the tax rates arising as a result of inflation.

Taxpayers can expect savings of $11 a week on income earned over $22,000 a year, and up to $20 a week for anyone earning more than $52,000 a year.

Independent Earners Tax Credit

The Independent Earner Tax Credit (IETC) is to be cancelled at the end of the 2017 income year. However, the loss of the IETC for those earning $24,000 to $44,000 is being incorporated into the increase to the income tax thresholds. With only a third of IETC eligible individuals actually claiming the credit, it is an overall positive change for those in that income range.

Working for Families

There has been a multitude of small changes to Working for Families. The Family Tax Credit rates will change, such that families with a first child under 16 will receive an additional $9 a week, and there will be an increase of between $18 and $27 per week for each subsequent child under 16.

The maximum amounts payable to households entitled to the Accommodation Supplement are also set to rise, as are the weekly payments for the Accommodation Benefit for eligible Student Allowance recipients.

The combined effect of these changes will hopefully provide families with greater disposable income to spend on goods and services. The aim is that the flow-on of income into consumer spending will strongly support economic growth over the coming years. The challenge for businesses then becomes how to make the most of growing consumer spending if they also want to benefit from this year’s budget.

PAYE changes and tax simplification

Inland Revenue (IRD) have recently released a new Taxation Bill and published the eighth discussion document in the Making Tax Simpler series, both of which aim to reduce the cost of tax compliance and administration for NZ businesses and individuals.

Under the current PAYE system, it can be difficult for IRD to collect the correct amount of tax from individuals over the course of a tax year. The nature of the system means that mistakes can be made when selecting PAYE codes, or if a person’s income changes unexpectedly the amount of tax withheld over the course of a year is not likely to be accurate, leading to tax refunds or liabilities at the end of the year.

IRD propose increasing the frequency that employers provide information to IRD from monthly to every payday, which could be weekly or bi-monthly for some employees. This will be facilitated by the integration of accounting software with the IRD system, so that employee income and deduction information can be sent to IRD with a simple ‘push of a button’. PAYE information will be sent as pay checks are processed, so payroll reporting will become an integral part of the tax process rather than a separate and additional function for employers. This will reduce the tax administration involved with employing staff and ease the compliance burden for businesses.
The draft Bill also proposes that more detailed information will be collected more regularly on individuals’ investment income, such as interest, dividends, portfolio investment entity (PIE) income, taxable Māori authority distributions and royalties.

The new rules will require the payer to submit information about individuals to IRD on a monthly basis, or whenever payments are made if the payment frequency is less than a month.

Taxpayers will still be responsible for providing any additional information to IRD, such as rental or self-employed income, however it will be possible for this to be provided via the online ‘MyIR’ system.

The IRD estimate that an additional $21 – $27 million of income tax revenue will be collected per annum under the new rules, and an additional 185,000 individuals will have their investment income included when determining their Working for Families entitlements, allowing more accurate calculations.

In summary, the proposals aim to use digital solutions to simplify the tax administration process. Both the PAYE changes and introduction of detailed reporting for investment income will give IRD more real-time information and ultimately give the Government greater insight into a taxpayer's financial position. This will open up opportunities to redesign social policies and improve the future administration of other systems such as child support, KiwiSaver, Working for Families and student loans.

Snippets

YouTube receipts

With over 400 hours of content uploaded every minute, YouTube comprises a massive entertainment platform. The site has over 1 billion monthly users, with a continual demand for quality online content across a diverse range of subjects.

Armies of users produce and upload videos, aiming to earn the most views, leading to opportunities to make money. Income can be generated from various sources, such as:
- Advertising revenue (e.g. Google’s AdSense campaigns);
- Affiliate and sponsorship income (paid for promotion of products or companies); and
- Paid content (where a fee is required in order to see the content).

The IRD has recently provided guidance regarding the taxable nature of such income, which is based on ordinary tax concepts. The key considerations are whether the individual is intending to make a profit, or is engaged in a ‘scheme or undertaking to make a profit’.

So, if you receive YouTube income you may need to include this in your income tax return, even if you did not intend to profit. If you are receiving amounts regularly or are relying on the amounts as a form of income, the income is likely to be taxable.

Think ahead to IRD requesting a list of NZ members that have received payments from YouTube over $XXXX ...