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NEWSLETTER

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INSIDE THIS EDITION

Charities review

Currently, Charities in NZ are broadly exempt from income tax. This is a choice that 'we' as a society have made. It is centred on the view that if an organisation is established for a charitable purpose, then 'we' should support that organisation and maximise the resources it has available to achieve its purposes.

There are often debates around how wide the tax exemption should apply. The case of Sanitarium, a health food company owned by the Seventh-day Adventist church, is often quoted as the 'case in point'.

On 24 February 2025, Inland Revenue released an Officials' Issues Paper titled Taxation and the not-for-profit sector. The release of the Paper represents the first step in a potential fundamental change to the taxation of charities in New Zealand.

One of the questions raised by Inland Revenue is whether income from a business that is unrelated to achieving its charitable purpose should be subject to income tax. It asks what are the most compelling reasons to tax or not tax such businesses, what are the most significant practical implications and how to define whether a business is related to a charitable purpose?

A flow on question becomes, if a business owned by a charity is subject to tax and that after tax profit is subsequently applied for a charitable purpose, should the charity receive a tax credit i.e. a tax refund. This would be akin to a charity making an interest free loan to the Government that is repaid when cash is applied for a charitable purpose. At least a bank pays interest…

A further focus from Inland Revenue is donor-controlled charities and whether additional rules are required due to the risk of tax abuse. The key proposed changes appear to be whether to restrict how tax exemptions apply to donor-controlled charities and their business operations and whether to introduce a minimum distribution amount that must be applied for a charitable purpose each year.

To the extent a charity pays tax, it has less cash available to be applied for a charitable purpose. What is missing from the Inland Revenue Paper is how that funding shortfall is to be met to ensure a net drop in charitable services does not arise. Even cash which is reinvested into a business operated by a charity, reduces the need for bank funding which would otherwise reduce the net profit able to be applied to charitable activities. Will the Government make up the difference?

It is also curious that the Paper provides no ideas or consideration to changes that might help or support New Zealand's charities. A one-sided Paper indeed.

Navigating insurance proceeds and tax

When the unexpected happens — a fire, flood, or major equipment failure — insurance proceeds can provide some welcome relief. However, from a tax perspective, how that payment is treated isn't always as simple as it first appears. While many businesses instinctively classify insurance proceeds as taxable income, this is not always necessary. Applying the correct tax treatment can potentially reduce your tax liability.

If the insurance proceeds relate to a depreciable asset that's been lost or destroyed, the key comparison is between the proceeds and the asset's adjusted tax value (ATV). The ATV of an asset is calculated by subtracting any depreciation claimed from the asset's original purchase price. It reflects the remaining value of an asset for tax purposes, which may differ from its market value.

To determine the appropriate tax treatment, you should consider the following high-level guidelines:

- If the proceeds exceed the ATV but are less than the original cost, the difference should be treated as taxable income.
- If the proceeds exceed both the ATV and the original cost, only the amount up to the original cost is taxable income. The additional amount should be treated as a capital gain for tax purposes.
- If the proceeds are less than the ATV, the difference should be treated as a loss on disposal.

For damaged assets, where the insurer covers repairs, the proceeds should not be taxable, and no deduction is allowed for the repairs. However, if the proceeds received exceed the actual repair costs, the excess reduces the asset's ATV. If this reduction results in a negative ATV, that negative amount becomes taxable income, to the extent of depreciation claimed.

Another aspect to consider is the GST impact. Ordinarily, insurance payments made to GST registered businesses or individuals are made on a GST inclusive basis. Therefore, the insurance proceeds should be included in the GST return for the period they are received. Conversely, when the replacement assets are purchased, the GST on these costs should be claimed back.

As we know from natural disasters and significant events across New Zealand in the last few decades, the insurance process can stretch over a number of years. Consideration should be given to whether Inland Revenue has made any specific concessions (as observed with the Canterbury Earthquakes and Cyclone Gabrielle), timing of asset disposals, allocation of insurance proceeds and treatment of split payments.

Remember, not all insurance proceeds are taxable. Assess what the payment was for and how it aligns with the ATV to ensure the correct tax treatment.

Tax pooling

Most people have heard of "tax pooling", but it is common for people to say they have heard of it "but, I don't really get it". Here is an explanation of tax pooling. For the purposes of provisional tax and tax obligations generally, a fundamental aspect is the "effective date" of a tax credit. This being the date a credit is treated as 'received' by Inland Revenue (IRD). If not received at the right date, interest and penalties could apply. Tax Pooling allows a business that has not paid tax at the right date, to 'purchase' tax with a specific effective date.

To illustrate, take the impact of the Covid-19 pandemic on Air New Zealand (Air NZ). For the 30 June 2019 financial year its pre-tax income was $382m. However, for the 30 June 2020 year it made a loss. It went from one extreme to the other.

Air NZ has a 30 June balance date, but for this purpose we'll treat it as though it has a 31 March balance date, to make this explanation more commonly applicable. Under the standard provisional tax uplift method Air NZ would have been required to make provisional tax payments as it went through the 2020 year. Let's assume it made the following provisional tax payments:

1. 28 August 2019 $37m
2. 15 January 2020 $37m
3. 7 May 2020 $37m

In total $111m in provisional tax that is ultimately not needed because it ended up making a loss.

Meanwhile, imagine a small local coffee and food delivery company that 'boomed' because it was able to go-online and satisfy the caffeine needs of individuals who worked from home. Under the standard uplift method, the business expected to have a tax liability of $150k and therefore made provisional tax payments as follows:

1. 28 August 2019 $50k
2. 15 January 2020 $50k
3. 7 May 2020 $50k

In December 2020 its income tax return was completed and the owners find their final tax liability for the year is $550k, i.e. they need to pay a further $400k. Under the 'use of money interest' rules, IRD charge interest on that $400k shortfall from 7 May 2020. In a net sense, as at the 7 May 2020, the coffee company has a tax shortfall of $400k, whilst Air NZ has excess tax credits (at that date) of $37m.

The rationale behind tax pooling is that rather than IRD paying interest to Air NZ and charging interest to the coffee company, Air NZ can 'sell' $400k of its excess tax to the coffee company (and others) with the tax credit transferring across at an effective date of 7 May 2020; and therefore, no interest is charged by IRD.

The coffee company pays a fee (interest) to 'purchase' the tax credit, but it is less than the interest amount that would have been charged by IRD. Part of that fee is paid to Air NZ, but it is more than what IRD would have paid Air NZ in interest. A tax pooling intermediary acts as a broker to connect the two and 'clips the ticket' on the way through. Everyone wins.

Trust disclosure review

From the 2021-2022 income years onwards, the Inland Revenue (IRD) introduced increased disclosure requirements for trusts. The increased disclosure requirements were aimed at supporting the Commissioner's ability to evaluate compliance with tax rules, develop tax policy, and assist with understanding and monitoring the use of trust structures and entities.

In effect, it appeared as though the Government of the day was trying to gather intelligence to understand how trusts were being used to 'minimise' tax liabilities. A cynical person might also hypothesise the information could be used to estimate the revenue that could be generated from a capital gains tax.

In practice, accountants have found the increased disclosures unnecessarily complex (the 2019 trust tax return guide was 57 pages, the 2024 guide is 88 pages) and confusing, which has given rise to increased cost that invariably is passed onto clients. For example, loans with associated persons are separated from beneficiary current account balances. But the distinction is arbitrary when both amounts represent loans to and from associated persons. The value of shares are to be recorded in one box, but shares held as part of a "wider managed investment portfolio" are to be recorded in a separate box. If a person has a single parcel of Microsoft shares managed by Craigs, which box does it get recorded in?

IRD has now completed a review of the trust disclosure rules to determine whether changes should be made. In its review, IRD acknowledge that certain changes should be made to reduce the compliance costs for taxpayers. Recommendations from the review include reducing granularity by removing unnecessary breakdowns, reducing the number of subjective tests and improving the guidance and forms. IRD also commented that going forward the development of any changes to trust disclosure rules will take into account whether it will result in additional one-off compliance costs.

Two minor changes from the 2025 income tax return onwards include trustees no longer being required to distinguish between whether a non-cash distribution was a distribution of trust assets, the use of trust property for less than market value, or the forgiveness of debt. Trustees are also no longer being required to distinguish between whether a cash distribution was made from trust capital or corpus. A future change should see information being pre-populated from disclosures in prior years.

Alongside their review, the IRD engaged Cantin Consulting to complete an independent review. Interestingly, unlike the IRD report, this commented on the lack of support these disclosure rules have from taxpayers and their advisors.

The compliance costs coupled with the scepticism around the purposes of these rules has led to the view that these rules are not worthwhile. It also highlighted the view that the rules have given IRD a better understanding of trusts and that without these rules the degree of focus and insights on trusts would not have occurred.

Compliance with the trust disclosure framework has been frustrating for practitioners, hence the review that has now occurred, including the opportunity to provide feedback. The resulting changes are welcome.

Fringe Benefit Tax proposals - the death of the ute

On 1 April 2025, Inland Revenue released its issues paper 'Fringe Benefit Tax - Options For Change', proposing significant changes to the Fringe Benefit Tax (FBT) regime, which has been in place for 40 years. The Issues Paper sought feedback from the public on a number of proposed changes to the regime aimed at reducing compliance costs and simplifying the calculation and filing process.

One of the most notable of the proposed changes is the complete removal of the 'work related vehicle' concession. Instead, the amount of FBT payable on vehicles would be determined based on the way in which they are used, rather than their physical characteristics. Other proposed changes to motor vehicles are the removal of the tax book value method, emergency call exclusion, allowing vehicles used for emergency services to be exempt from FBT at all times and allowing incidental use of pool vehicles.

New rates are also proposed for calculating the taxable value of a vehicle benefit. The current per annum rate is 20%. The proposed per annum rates are:

- Petrol / Diesel vehicles: 26%
- Hybrid vehicles: 22.4%
- Electric vehicles: 19.4%

Three categories of vehicle use are proposed:

- Category 1: predominantly available for unrestricted private use (100%).
- Category 2: predominantly business use with restricted private use, home to work only (35%).
- Category 3: business use only, with no personal use other than driving to multiple worksites (no private use).

Categories 2 and 3 are considered similar, with one of the distinctions being whether the employee is usually travelling to the same workplace (category 2), e.g., a fixed office each day, or if they are regularly going to different workplaces (category 3). The logic for the difference is that if an employee has a fixed place of work, the home to work travel is of a private nature, whereas a more itinerant employee (like a builder or a plumber) is travelling "on work" when they leave for their first job location.

To illustrate the effect, we have prepared a before and after comparison table below for a ute based on the following facts: a cost of $60k + GST, provided to an employee with a salary of $80k, qualifies as a work-related vehicle, and use is restricted to home to work travel on Monday to Friday, but fully available on weekends. Due to the availability on weekends, it would appear that the ute falls into category 1.

	Annual rate	**Private use days**	**Taxable benefit**	**FBT rate at 49.25%**	**GST on FBT**	**Total liability**
Current legislation	20%	104	$3,419	$1,684	$513	$2,197
Proposed rules	26%	365	$15,600	$7,683	$2,340	$10,023

We are at an early stage in the consultation process with draft legislation still to come, but there has been 'noise' around Inland Revenue's view of the FBT treatment of utes for years. This could be the start of the end of the current concessionary methodology.

Snippets

IRD reassessments without notice

On the 29th March 2025, the Taxation (Annual Rates for 2024−25, Emergency Response, and Remedial Measures) Act received Royal assent.

Of note is that the Act includes an amendment to section 89C of the Tax Administration Act 1994 relating to Inland Revenue's (IRD) ability to amend an assessment without completing the formal disputes process.

The amendment adds a new provision stating that if a "qualifying individual" provides information to IRD relating to their taxable income and then fails to respond within two months to a request from IRD for additional information, IRD is able to amend their tax position without the need for notice.

The provision is aimed at individuals that need to disclose income that is not otherwise reported to IRD, such as a salary or wage earner who also incurs a rental loss. If that person subsequently discloses the rental income to IRD, but then fails to respond to a request for more information, IRD will have the right to amend the tax position.

The change appears to be as a result of frustration from IRD that certain individuals don't engage and ignore follow up requests. At this stage, it is unclear how this power will be exercised and how frequently, but it does mean requests for more information from IRD should not be ignored.

Australian budget

With the New Zealand Budget set to be released on 22 May 2025, it is worth looking over the ditch and seeing whether the grass in Australia is greener as a result of their Budget that was released on 25 March 2025.

A tax cut was introduced for individuals. The rate applying to income between AU$18,201 to AU$45,000 will reduce from 16% to 15% from 1 July 2026 and to 14% from 1 July 2027. As a comparison to NZ, it is worth remembering that Australians enjoy a tax-free threshold up to AU$18,200. This equates to an extra AU$268 and then AU$536 extra 'in the hand' across the two years.

A change that will be of interest to New Zealand students is the plan to complete a one-off 20 percent cut in existing student loan balances.

For an embattled hospitality sector and beer drinkers, a pause in the indexation of draught beer excise will occur for two years at an estimated cost of $200m.

With a roading and infrastructure spend of AU$17.1B we can only be jealous of the investment that Australia is able to make, throw in a beer and a tax cut and the grass keeps looking greener.

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