INSIDE THIS EDITION

Labour shortages

A new year's resolution to grow your business is likely to require growing your team. However, it's fair to say that the labour market is tight at the moment and recruitment for staff is taking much longer, with a reduction in both the number and skills of applicants. What is driving it? Is it a NZ issue only, or is there a wider global issue at play?

An obvious observation is the closure of our borders for over two years which prevented international employees from entering the NZ labour market. The hospitality industry in particular has been feeling the impact of this over the past year. Not being able to draw upon the pool of individuals travelling around New Zealand to experience their "OE" has meant it is rare to not see a "short of staff, please be patient" sign when dining out. The re-opening of our borders in mid-2022 has had the equal and opposite impact, with some skilled New Zealanders finally able to take steps to move and work overseas, thereby reducing the labour pool.

In an attempt to attract high-skilled workers from overseas for the long term, NZ's "Green List" (previously known as the skills shortage list) was significantly expanded in December 2022. Roles added to the "straight to residence" tier include registered nurses and midwives from 15 December 2022, and registered auditors from March 2023, with secondary and primary school teachers being added to the "work to residence" tier from March 2023.

Another theory is that we have an overreliance on labour trained overseas, and that employers are reluctant to invest in the education of migrant workers to ensure they are ready for the NZ workforce, which often means they leave. This theory suggests that NZ's labour shortages predate the pandemic, and that underlying fundamental changes need to occur in the way employers treat migrant employees in order to see any improvements.

Another popular suggestion is that we are currently undergoing a structural change in our employment demographic with a "retiring population", which sped up due to the pandemic. Due to the various lockdowns and challenging work environments in recent years, experienced employees who had intended on working for several more years instead decided to retire early. In America, there are around 3.5 million fewer people in the job market compared to pre-pandemic, of which, 2 million has been attributed to this unexpected surge in retirements.

As the labour shortage lingers, employers will need to think of creative ways to attract and retain valuable staff, or either pivot and automate a particular role or simply discontinue it.

Residential property – A class of its own

Despite recent reductions in property prices, there is little doubt that the passion New Zealanders have for investing in residential property will survive. However, the tax treatment of residential rental investments has increasingly become a tangled web of complexity due to changes in legislation over the past few years.

It used to be that 'mum and dad' would setup a look through company, purchase the property, all expenses would be claimed (including interest and depreciation) and the loss would offset against other income and be 'exchanged' for a tax refund. Years later when the property was sold, the profit was a non-taxable capital gain. Simple. Roll forward to today and:

- Excess tax losses are 'ring-fenced', carried forward, able to be offset against future rental income and offset against taxable income arising from the disposal of a residential property.
- Depreciation is no longer able to be claimed on residential rental properties, even though it was re-introduced for commercial properties.
- Interest on debt incurred to purchase a residential rental property prior to 27 March 2021 is currently being phased out. If a property is purchased on or after 27 March 2021, interest is non-deductible from 1 October 2021. However, if the property qualifies as a new build, interest remains deductible. The cost of increasing interest rates is being exacerbated by this change because a tax deduction would have otherwise been able to be claimed.
- Finally, the 'capital gain' on sale may also be taxed under the brightline rule. This itself has been extended from an initial 2 year period, to 5 years and is now 10 years, while new builds remain under a 5 year period. This creates the need to not only examine the date of acquisition and sale to quantify the ownership period, but also work out which bright line period actually applies.
- Where a taxable loss on disposal is incurred within an applicable brightline period, it must be carried forward and can only be offset against income from future taxable land disposals.

A cynical person might suggest the next change will be to prohibit a deduction for accounting and legal fees incurred to navigate the rules.

The changes have altered the residential property landscape, placing residential properties into their own category by virtue of their tax treatment. It is now common for landlords to have an income tax liability, even though the property has not made a profit. Whether these changes have fed into the current challenges facing the residential construction sector is unclear, but it is unlikely that they have helped.

Grocery Industry Competition Bill

Given recent media coverage on the increasing cost of living in New Zealand, and in particular the cost of groceries, the introduction in November 2022 of the Grocery Industry Competition Bill (Bill) will have struck a chord with many households as they face the ongoing challenge of putting food on the table.

The Bill has come in response to the Commerce Commission's market study report (report) into New Zealand's retail grocery sector.
The report described the sector as not working well for consumers, with the main grocery retailers Foodstuffs (includes Pak'n'Save, New World, Four Square) and Woolworths (Countdown, SuperValue, FreshChoice), operating as a duopoly. Key findings from the report include:

- the intensity of competition between the major grocery retailers is muted and does not reflect workable competition;
- entry and expansion by other grocery retailers is difficult;
- the profitability of the major grocery retailers appears higher than expected under workable competition;
- prices appear high by international standards; and
- competition is not working well for many suppliers due to an imbalance in bargaining power.

The report states, "If competition was more effective, the major grocery retailers would face stronger pressures to deliver the right prices, quality and range to satisfy a diverse range of consumer preferences".

The Bill deals with the bulk of the Commission's recommendations including the following.

Wholesale supply - The Commission reported that the main grocery retailers achieve significant cost advantages over other grocery retailers with respect to their vertically-integrated wholesale and distribution; which primarily supply their own operations. Consequently, other retailers are at a significant disadvantage in being able to secure products at prices that will enable them to be competitive. To address this, the Bill will require the major grocery retailers to facilitate the wholesale supply of groceries to other grocery retailers. Initially the onus has been put on the major retailers to do this voluntarily, however, a set of "backstop" regulations would be created that may be imposed if a "workably competitive" grocery wholesale market does not emerge.

Imbalance in bargaining power – The market study found that suppliers had few alternatives to the major grocery retailers to sell their products. The resulting imbalance of power has seen the major grocery retailers leverage this advantage; forcing suppliers to accept unfavourable terms of supply. To address this imbalance, the Bill would:

- implement a grocery supply code to protect suppliers from unfavourable terms of supply;
- enable certain suppliers to engage in collective bargaining with major grocery retailers; and
- strengthen the unfair contract terms regime in the Fair Trading Act 1986 to make these protections more available to suppliers of groceries.

Grocery regulator – To oversee the industry, the Bill will appoint a Grocery Commissioner within the Commerce Commission. The Commission will have a key role in administering the Bill once passed; its regulatory powers would include:

- requiring commercial and non-commercial information about grocery wholesale prices to be disclosed;
- issuing corrective notices and warnings; and
- seek remedies from the court to enforce compliance with the regulatory regime.

Restrictive covenants ban - In addition to the items covered in the Bill, research from the market study showed that alongside price, convenience was one of the main drivers in determining where consumers do their grocery shop. It was revealed that the lack of available sites for new entrants to the market was being constrained by the major grocery retailers use of restrictive covenants on land and exclusivity covenants in leases. These covenants prevented potential competitors from opening grocery stores in close proximity, or in areas the major grocery retailers did not want them to get a foothold. In response, in June 2022 the Government passed into law the Commerce (Grocery Sector Covenants) Amendment Act 2022, which has banned these practices.

The Bill has passed its first reading and is before the Select Committee with its report due back by 23 March 2023. The Bill is expected to come into effect by mid-2023.

IRD - Whether a subdivision was subject to income tax and GST

In November 2022 Inland Revenue issued TDS 22/21, a Technical Decision Summary on whether the profit from a subdivision was subject to income tax and GST.

TDS 22/21 covered a dispute involving a subdivision by the taxpayer of land into two lots. The taxpayer had acquired the property for the purpose of renovating and expanding it to live in with extended family. The taxpayer and extended family moved in, but after commencing renovation plans found that the existing dwelling had serious issues with drainage and asbestos. As a result, the taxpayer decided to demolish the existing dwelling, subdivide the land into two lots and construct two new dwellings ('House A' and 'House B'). While the subdivision took place the family moved into a rental and subsequently moved into 'House A' when it was constructed. 'House B' was sold shortly after construction to a third party.

When determining whether a gain on disposal of land is subject to income tax, various land taxing provisions must be considered. If the taxing provisions don't apply, or a specific exclusion to a taxing provision applies, then the gain should not be taxable. Inland Revenue's Customer &

Compliance Services (CCS) team took the view that the following sections applied to tax the gain on sale of House B:

- The taxpayer entered into an undertaking or scheme for the dominate purpose of making a profit (section CB 3).
- The taxpayer acquired the property for a purpose or with an intention of disposing it (section CB 6).
- The disposal was a more than minor scheme for development or division begun within 10 years of acquisition (section CB 12) and the residential land exclusion (section CB 17) did not apply.

The CCS team also argued that a taxable activity was carried out and the sale should be subject to GST.

The Tax Council Office (TCO) disagreed with these assertions, predominantly due to the taxpayer's intentions at the time of acquiring the property. As the property was acquired for the sole purpose of housing the taxpayer and their family members, the taxpayer had no intention of disposing of the property or making a profit at the time of acquisition and therefore both sections CB 3 and CB 6 did not apply. Given the land was occupied mainly as residential land by the taxpayer and their family members before it was subdivided, the TCO found that the residential exclusion under section CB 17 was available to exclude CB 12 from applying. There was specific contention on the application of this exclusion, but it was noted that the exclusion is based on the taxpayer's intended use of the land, and that, under this exclusion, there is no requirement for the taxpayer to reside on the land for more than 50% of the time of ownership – it is not a time-based test.

The TCO also found that the sale was not subject to GST on the basis that it was a 'one-off' activity, and did not constitute a 'continuous or regular' activity – one of the requirements to be subject to GST.

It is good to see that the Tax Counsel Office, which itself is part of Inland Revenue, and made the decision, got to the right answer in the end.

Snippets

Close relationship transfers

Last year Inland Revenue issued a draft interpretation statement regarding bright-line and its application to certain family and close relationship transactions. The publication relates to the 5-year bright line test for residential land purchased between 29 March 2018 and 26 March 2021, with a subsequent publication to be issued for the 10-year test applying from 27 March 2021. However, the expectation is that the conclusions reached will remain unchanged.

In essence, the publication confirms that no additional roll-over relief will be provided for close relationship transfers. Where there is a legal change in ownership taking place within the bright-line period, the sale will be taxable to the person disposing of it. Furthermore, all family and close relationship transactions that occur at below market value are deemed to have been transferred at market value. This may give rise to situations where tax is payable on an amount of income that was not actually received by the recipient. For example, where parents dispose of residential land to their child within the bright-line period, the sale will be taxable to the parents based on the market value of the land, regardless of how much the child paid for it.

Similarly, where a person wholly-owns land and wishes to become co-owners with their partner, a sale within the bright-line period is taxable but only to the extent that the land is changing ownership i.e. no tax is payable on the share held by the original owner.

Parents wishing to assist their children in buying residential property should carefully consider the ownership structure and alternate options before settlement; for example, should nominee/bare trustee legal documentation be executed prior the original purchase to reflect the nature of the arrangement?

Private school donations

Private schools are typically registered as a charity, and thus parents will at times treat payments to the school as a charitable donation for tax purposes. Inland Revenue are making it clear on its interpretation on this subject through the release in October 2022 of QB 22/09 – Income Tax – Payments made by parents to private schools and donation tax credits. In summary, payments will qualify as a "gift" for donation tax credit purposes when all of the following apply:

- the school is a donee organisation;
- the payment is money of $5 or more;
- the parent makes the payment voluntarily to benefit the school either generally or for a specific purpose or project; and
- the parent or child gains no material benefit or advantage in return for making the payment.

Below are examples which Inland Revenue asserts will not be eligible for a donation tax credit:

- A "donation" which results in a discount on tuition fees, or the payer's business being advertised in a school publication.
- Contributions requested by the school with reference to its operating costs, number of students and each family's circumstances.
- A donation of a non-cash prize for the school to use in a fundraising auction.
- The purchase of a ticket for a school event (e.g. quiz night), where part of the ticket proceeds will go towards a school project.

It would be wise to assume the circumstances surrounding a payment to a school will be reviewed by Inland Revenue if a charitable donation is claimed.

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