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An introduction to the metaverse

No physical interaction, no leaving your home, talking to people over the internet - a COVID nightmare, or the future of our society? The metaverse is a topic that has gained a lot of traction recently, particularly with Facebook's rebranding to 'Meta' and its announcement that it will now be especially focused on creating its 'metaverse'.

In order to understand what the metaverse is, it's best not to think of it as a singular place, but rather as an adjustment in how we interact with the online world. Generally, it involves an aspect of virtual reality, whereby users access the metaverse through a 'virtual reality headset' that places them inside the world. Many companies are now looking at ways to capitalise on this, by creating ways for customers to interact with them in a virtual world as opposed to real life.

In essence, it isn't too different from when you shop on the internet. The metaverse simply aims to make the experience more immersive, bringing you closer to the 'real-life' experience.



By now most of us have heard the crazy headlines - virtual real estate sales in the metaverse topped \$500 million last year, with someone spending \$630,000 just to buy a digital

home next to musician 'Snoop Dogg'. While stories like these may appear hard to relate to, there are genuine business applications 'in' the metaverse.

As technology advances, the face-to-face business meetings we have today could be replicated in the metaverse, allowing us to interact and converse in a more natural way, as opposed to awkward zoom calls. In terms of real estate, you could walk through a home you're interested in and get a real sense of the space, without having to leave your living room. Or perhaps you want to 'try on' a multitude of outfits without going through the hassle of going through the store and finding everything.

In a post-COVID society, businesses are scrambling to find ways to continue to exist, without the threat of pandemics and lockdowns. The metaverse may be key to providing a way for businesses and customers to interact, regardless of what is happening in the outside world. Is it a case of "get on the bus or get left behind"? Maybe not. A recent survey by research firm Gartner found that 63% of CEOs see the metaverse as not applicable or unlikely to be a key technology for their business.

In reality, we are a long way off from the metaverse becoming the norm. However, like with any new technology, having an early awareness could open opportunities for many businesses, while ignoring it could see businesses to get left behind.



Attribution vs market salary rules

The introduction of the 39% tax rate for individuals who earn over \$180,000 from 1 April 2021 has reignited Inland Revenue's interest in the income attribution and market salary regimes. These rules currently prevent a person from having income earned from individual efforts or "personal services" taxed through an associated entity at a lower tax rate. With an 11% difference between the top individual tax rate and the NZ company tax rate, the application of these rules is likely to be closely scrutinised in upcoming years.

The attribution rules will generally apply when a taxpayer who earns income of more than \$70,000 from personal services inserts an associated entity between themselves and the party acquiring their services. These rules do not strictly apply if the associated entity derives income from numerous, unrelated parties, provided one party does not make up 80% or more of the entity's income.

For example, compare the two scenarios:

1. Paul contracts Sarah Limited for \$200,000 – all the services are performed by Sarah, and Paul is Sarah Limited's only client.
2. Four non-associated individuals: Paul, Eugene, Rebecca and John, each contract Sarah Limited for \$50,000 each – all the services are performed by Sarah.

The income attribution rules would only apply to scenario 1 above, forcing Sarah to return all of Sarah Limited's net income in her personal tax return.

However, in the second scenario, although the income attribution rules do not apply, the market salary principles still need to be considered to determine the amount of income to return in Sarah's personal tax return.

The Supreme Court established the leading precedent in the case of *Penny & Hooper v Commissioner of Inland Revenue* (2009) that a failure to pay a "commercially realistic salary" for services rendered is an important consideration in determining whether an arrangement amounts to tax avoidance.

Revenue Alert 21/01, released on 29 March 2021 ahead of the increase in the top marginal tax rate, also provides further guidance and states that Inland Revenue is more likely to examine arrangements where the salary paid from an entity to an associated working individual is less than 80% of the entity's net income. While this is not a legislated *de minimis* rule, it suggests it is unlikely Inland Revenue will challenge the amount of an individual's salary if the 80% threshold is met. On the other hand, not meeting the threshold should not automatically amount to tax avoidance.

Both the attribution and market salary regimes should be kept in mind when determining salary levels. People don't often appreciate that there is both a specific set of income attribution provisions to consider and a separate market salary principle as per 'Penny & Hooper'.

Rollover relief – Does it go far enough?

Residential property acquired after 27 March 2021 is subject to a 10-year bright-line period, or 5 years if the property qualifies as a 'new build'. The extension to 10 years has increased the likelihood that a property transfer will be caught.

In an attempt to alleviate the risk that related party transfers would be unfairly taxed, some rollover relief was enacted on 30 March 2022 as part of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 and applies to disposals of land occurring on or after 1 April 2022.

The legislation is complex and attempts to cater for numerous factual situations, but at a high level, the rollover relief provisions allow residential property to be transferred at cost, rather than deemed market value, resulting in no taxable gain on the transfer. Further, such a transfer does not restart the "bright-line clock" – the acquisition date under the bright-line provisions for the recipient would be the original acquisition date of the related transferor.

Where residential property is transferred to a family trust, rollover relief will apply in the following circumstances: each transferor of the land is also a beneficiary of the trust and at least one of the transferors of the land is also a principal settlor of the trust, and each beneficiary who is not a principal settlor is one of the following:

- within four degrees of blood relationship with, or married to, or in a civil union or de facto relationship with, a beneficiary who is a principal settlor,
- a company where a 50% voting interest is owned by a family member beneficiary,
- a trustee of another trust that has a beneficiary who is also a family member beneficiary of the test trust, or
- a charity.

Rollover relief will likely only apply to transfers of residential property from a family trust (where the beneficiaries are as outlined above) to a principal settlor of the trust. Given that the rollover relief is intended to apply where the economic ownership of the property has not materially changed, transfers of residential land to or from LTC's and partnerships may also qualify for rollover relief. However, this only applies where each person transferring the land has the same economic interest before and after the transfer.

Rollover relief will also apply where transfers of residential land take place within a wholly-owned tax consolidated group of companies.

Given that the 'Bank of Mum and Dad' is now NZ's 5th largest home loan lender, these concessions do not go far to help the many who have their property partly or wholly held by their parents or a family Trust. Where a family trust wishes to transfer ownership of its property to a 'child' beneficiary, rollover relief will only apply if the child is also a principal settlor of the Trust – a scenario which would be few and far between.

For parents who own a house directly 50/50 with a child, the parent's transfer of their 50% to the child would not be eligible for rollover relief at all, and hence it would be a case of waiting out the bright-line period to avoid any inadvertent and potentially material tax bills.



Are Technical Decision Summaries the key to information transparency?

Inland Revenue has started publishing Technical Decision Summaries (TDS') from mid-2021. A TDS is an abridgment of either an adjudication or private ruling decision made by Inland Revenue's Tax Counsel Office (TCO).

TDS' will be published within three months of a technical decision being finalised. They are not binding and are for information use only, and will be archived after five years of publication. A TDS contains four sections: facts, issues, decisions, and reasons for decisions.

Not all private rulings and adjudication decisions will be published, but the aim is to make Inland Revenue decisions and processes clearer and more transparent, to aid taxpayer compliance and support the integrity of the tax system.

With Inland Revenue's apparent heightened activity on the GST treatment of land sales and purchases, a recent topical TDS is 22/10 GST: Whether property sale is zero-rated. Time bar. In this TDS, the taxpayer was a GST-registered company whose taxable activity involved building residential properties for sale. The taxpayer entered into an agreement for the sale of a dwelling – the purchase price was stated to be "inclusive of GST (if any)", the going concern clause had not been deleted, and the purchaser stated they were also GST-registered. The GST clauses were not fully completed by settlement – the purchaser had not indicated whether they would use the property to make taxable supplies. However, the property was settled as a zero-rated supply for GST purposes.

Weeks after settlement, the purchaser's solicitors amended the GST schedule, confirming GST registration and signalling they did intend at settlement to use the property for making taxable supplies. Further, the purchaser applied for

holiday home registration in respect of the property.

The TCO decision was that the sale should not have been zero-rated as a supply of a going concern, nor under the compulsory zero-rating provisions. The latter decision was on the basis that, at the time of settlement, there was insufficient evidence to prove the purchaser intended to carry on a taxable activity of supplying short-stay accommodation, and the onus was on the taxpayer, as the vendor, to correctly determine the amount of GST payable.

Four years had passed from the GST return assessment period, hence the Commissioner had applied to amend the assessment under the time-bar exception on the basis the taxpayer knowingly or fraudulently failed to disclose all the material facts that were necessary for determining the amount of GST payable. This was rejected by the TCO, who considered that the available evidence suggested the taxpayer filed its GST return believing its position to be correct. As a result, time-bar applied to the transaction and the proposed amendment to re-assess the return was rejected.

This TDS provides useful insight into how Inland Revenue apply both the GST zero-rating and time-bar provisions and is written in a simple language for all readers.

It also highlights, once again, the need to take care when completing sale & purchase agreements – even though a transaction factually qualifies for compulsory zero-rating, if the GST clauses have not been correctly completed by settlement, the TDS implies Inland Revenue are unlikely to be sympathetic.



Free Xero Trainings

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Client Survey

At PKF Hamilton, we believe that the right people can make all the difference. Our team is made up of experts who are passionate about helping businesses like yours succeed. We'll take the time to understand your goals and needs, find a solution that fits them, and work tirelessly until it's done.

With this, we'd like to thank our clients for your trust in PKF Hamilton. We appreciate all the kind words and for choosing us as your accounting and tax services provider!

We always strive to provide the best service possible, and we're thrilled that we've been able to meet or exceed your expectations. Your satisfaction is our number one priority, and your testimonials help us make sure we are doing everything we can to keep you happy.

We love seeing what you have to say about us.

Please take our quick survey [here](#).

It won't take more than a few minutes of your time and you can complete it at any time during the day.



Snippets

Depreciation on buildings

On 20th July 2022 Inland Revenue released a 51-page interpretation statement 22/04 – Claiming depreciation on buildings.

In light of the re-introduction of depreciation on non-residential buildings from the 2021 income year, the interpretation statement is intended to give guidance to building owners on when they can claim depreciation on buildings.

Specifically, the statement emphasises the importance of understanding the difference between a residential building – where the depreciation rate remains at 0% – and non-residential buildings.

The basis of the interpretation statement appears logical enough, however, it includes the following surprising statement:



“where a building is used for both residential and non-residential purposes, it will only have a depreciation rate of greater than 0% if it is predominantly or mainly used for non-residential purposes: it is effectively an all-or-nothing test”

This is relevant, for example, where a building that has retail shops on the ground floor and residential apartments on the first floor, or in a rest-home context where there may be independent living apartments within a building that also provides hospital or assisted care.

The statement provides that the “predominant use” of the building must be established to determine whether the applicable depreciation rate for the entire building is more than 0%. This suggests (but not specifically commented on) that the owner of a unit titled residential apartment in a predominantly commercial building, is able to depreciate it at the commercial building rate.

Building owners who own all or part of a mixed-use building should read the interpretation statement carefully to determine their depreciation obligations.

Sick leave balances taking a hit

There are over 28,000 registered charities in New Zealand. Whether it's a cold, flu, a tummy bug from day-care or the notorious C-word, we're only partway through winter and already the amount of sick leave being taken seems higher than normal.

In New Zealand, most employees are entitled to 10 days of paid sick leave per year – this was only increased recently on 24 July 2021 from 5 days. We also allow unused sick leave to be carried over to the next year, to a maximum of 20 days. But how do we stack up against other countries?

In the US, there are no federal law requirements to provide paid sick leave. Such an entitlement is considered a luxury and not a right, and as a result, any entitlement is provided at a state level. The amount of paid sick leave varies on a state-by-state basis, but most of the states that do have sick leave policies cap the amount at a maximum of 40 hours (~5 days) per year.

However, there are still approximately 18 states that do not require employers to provide their employees with paid sick leave, and further, some of these states also have pre-emption laws to prevent cities and local governments from implementing paid sick leave requirements.

In the UK, the legislated weekly sick leave allowance is only ~20% of the average employee's income.

On the other end of the spectrum, employees in Sweden are entitled to 80% of their salary for up to a year. In Slovenia, the entitlement is unlimited and is also paid at the 80% rate.

Due to the number of lock-down periods over the past two years

keeping us sheltered from bugs and bacteria, prior to this winter many of us would have been sitting at the maximum accumulated 20-day amount – it's no wonder our immune systems and our sick leave balances are taking a hit!



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

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