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CHARTERED ACCOUNTANTS

NEWSLETTER

SUMMER 2020

Election outcome & tax policies

After Labour's victory in the 2020 General Election, their proposed tax policy changes are now likely to be implemented.

Labour has ruled out a capital gains tax and an increase in fuel taxes but is prepared to introduce a Digital Services Tax to target multinational digital businesses who have taken advantage of tax structuring options. Labour's historical coalition partner, the Green Party, have notably been campaigning for a wealth tax, which Labour has repeatedly ruled out. Given that Labour has won enough seats to govern alone, the possibility of a wealth tax seems unlikely.

Labour's election campaign promised no income tax changes for 98% of New Zealanders, however a new top marginal income tax rate of 39% for individuals earning over $180,000 will be implemented – expecting to raise $550 million of revenue a year.

For some of us this provides a sense of déjà vu, as we remember when we previously had a 39% tax rate from the 2001 to 2009 financial years. We saw disputes in the courts regarding the requirement to pay fair market salaries, legislation requiring income to be attributed to individuals and various policy statements from Inland Revenue.

As differences in tax rates widen, it impacts behaviour by incentivising tax planning to minimise application of top tax rates. Currently, there is little difference between the top income tax rates, 33% for trusts and individuals and 28% for companies.

It also leads to further inequity within the tax system because it is typically employees who are unable to alter how they are taxed, whilst business owners have greater flexibility to alter how their income is taxed.

For example, a distribution of accumulated income from a trust that has already been taxed at 33% may be distributed tax-free to a beneficiary who has a marginal tax rate of 39%. Individuals with investment income may also be further incentivised to invest in Portfolio Investment Entities instead of shares, where the top tax rate is capped at 28%. Conversations are likely occurring right now regarding whether shares in companies should be moved from personal ownership into trusts – and whether this is tax avoidance?

Companies will also face further costs with a 39% tax rate. Companies that currently pay fully imputed dividends at 28% are also required to withhold tax at 5% in order to reach the 33% marginal income tax rate. This withholding tax liability is likely to increase to 11%, which may place constraints on company cash flow or prevent dividends from being paid altogether. This will place further pressure on tax administration to keep accurate, up-to-date records as individuals on lower marginal tax rates may be entitled to tax refunds comprising the additional tax withheld.

Ultimately, this policy provides an opportunity for individuals to explore their different options to ensure efficient tax planning. However, utmost care should be taken when restructuring one's affairs, in order to avoid undesirable consequences such as the breach of shareholder continuity resulting in the loss of imputation credits or tax losses, or potentially undertaking a tax avoidance arrangement.

TAX TIPS, TRAPS & TROUBLES

BRIEFLY

Child support Bill

As new proposed child support legislation is just a Bill, so not yet law and can be changed, we make only a few comments:

- The late payment penalty system is to become less harsh
- Reassessment of child support will occur only once every four years
- Income will include interest and dividends, and losses carried forward will be ignored.

Air BnB and GST

Covid-19 has caused some people who were supplying Air B&B accommodation to switch to renting out their property. This is a switch from commercial renting to residential renting. GST applies to commercial renting for those who hit the $60,000 threshold for GST registration. If you switch your commercial rental, such as Air B&B, to residential renting you need to pay Inland Revenue GST on the value of the property, if the residential renting goes on for 12 months or more. This time has now been extended to 18 months provided the switch to residential renting occurs between 14 February 2020 and 31 October 2020.

Mortgage deferral

The six months mortgage holiday was set to end on 27 September 2020 and has been extended to 31 March 2021.

Unfortunately, interest continues to accrue on the debt so it is not necessarily a good idea to take advantage of the extended time.

Employee accommodation

The treatment of employee accommodation (and taxable allowances) can be confusing. In 2015 the rules around employer-provided accommodation were subject to a reform, with the changes intended to provide greater clarity and cohesion for employers to understand their tax obligations. Previously, a net benefit approach was acceptable, where accommodation provided to an employee was not taxable if the employee maintained a home in another location. Following the reform, the starting point is that accommodation provided to employees is taxable unless one of the exemptions apply (e.g. temporary, out-of-town secondment, work-related conference). But how should it be taxed?

Firstly, PAYE typically applies to the provision of a cash allowance paid to an employee. While FBT usually applies to a non-cash benefit (such as the use of a car). However, the provision of accommodation comprises taxable income and is subject to PAYE, rather than FBT.

The amount of taxable income is the market rental value of the employee accommodation, less any contribution to the cost by the employee.

There are a number of Inland Revenue publications available to assist employers with determining the market rental value. For example, Commissioner's Statement CS 16/02 sets out the Commissioner's opinion on factors that can and cannot be taken into account; and CS 18/01 suggests market value reductions in the form of percentages specifically for boarding school employers. The overarching theme of the guidance is that employers have flexibility when determining the market rental value as long as a reasonable process is followed, and sufficient evidence is maintained to support the values used. For example, an independent valuation

could be obtained by a registered valuer, or an analysis of comparable rental properties could be undertaken. Further, an employer is able to apply their own reduction percentages that they consider to be appropriate for any given accommodation type.

Although such guidance is useful, there is little Inland Revenue guidance regarding how to calculate the PAYE itself, which can lead to confusion.

The PAYE liability varies depending on whether the employee or employer pays the PAYE. If the employee's net income in the hand does not change with or without the addition of the taxable accommodation amount, then the employer is likely to be paying the PAYE. In this situation the market value of the accommodation should be grossed up and PAYE calculated based on the grossed-up amount. For example, assuming a 33% tax rate, a $300 market rental value would be grossed up to $448 to calculate a corresponding PAYE liability of $148.

If the employee receives less in the hand with the addition of the accommodation, the employee is funding the PAYE out of their salary or wage and the taxable amount is the market value of the accommodation itself. For example, a $300 market value would result in a $99 PAYE liability and the employee would receive $99 less in the hand.

Ideally, who is liable for the PAYE should be captured within the employment agreement, so that both parties know what to expect and are not caught out.

Be realistic with social media expectations

You're starting out in business, or maybe you've been in business a while but everyone is saying you need to have a social media presence.

If you agree, and if you're a small business, you have to be realistic in what you can do with social media.

The first rule is not to overdo the number of platforms you use. You just won't have the time or resources to maintain several accounts, so stick to just a couple. Unless you have someone dedicated to running them, you'll be distracted and overwhelmed if you have Facebook, Instagram, Twitter, Tumblr and so on.

Let's say you set up a Facebook page because you have big plans for marketing your business. You load it with lots of information and you get a few 'Likes'.

Then you realise you're going to have to put some effort in. To get your information in front of a lot of people, you need to get them following your page. So you have to market the page.

Then you have to keep posting on the page to keep it up to date. And you have to delete posts from other people because the posts are not relevant. And you have to reply to people who post or message you with often bizarre requests or information. You need to load photos and edit your posts so they're accurate and grammatically correct.

The message is if you're using social media, be prepared to put time and effort into it. It could mean up to an hour a day. Can you afford that when you need to be out making money for your business?

You might be better to provide a regular electronic newsletter specifically targeted for your clients, suppliers and prospects.

COVID Outcomes

COVID-19 has changed the way we work, travel, communicate and live. From overseas travel being only a memory to having to learn to cook during lockdown there are some interesting by-products of Covid-19.

PPE has become a fashion accessory with many large fashion companies entering the facemask industry to provide luxury facemasks due to the increase in demand, as well as many people channelling their inner fashion designer and taking the DIY route and making their own.

Enforcing social distancing has become creative. From a German café making people wear swimming pool noodles as hats to a restaurant in the United States designing 'bumper tables' which use a large inner tube to keep diners apart.

Artificial intelligence algorithms that look after inventory management, fraud detection and marketing became confused by the sudden and drastic change in behaviour.

And the changes continue with ANZ now not buying or selling foreign currency due to a decrease in demand arising from boarder restrictions.

Change in working from home rules

Inland Revenue has issued a statement, Determination EE002, setting out the payments it would approve as tax-deductible for an employer who pays an employee for the use of their home as a workplace.

This was done for businesses affected by Covid-19. The department has realised the working from home arrangements have become permanent for some people and has therefore dropped the requirement that working from home has to be because of Covid-19.

The determination now applies to anyone working from home.

IRD wants to have another look at this so it has extended the time limit to 17 March 2021. Hopefully it will come in with some permanent figures by that date.

You might find Determination EE002 a useful guide, but remember you don't have to apply it and you can use whatever figures you like, as long as you can justify them being for the actual use for work purposes.

Don't forget January tax date

Every year we seem to have a client or two who goes on holiday and forgets to pay their tax.

The second instalment of provisional tax for those with a March balance date falls on 15 January each year.

If you overlook this tax instalment and the resulting amount of use of money interest is large, it could pay to buy the tax from a tax intermediary. This is something we could arrange for you. It would enable you to avoid the penalty and reduce the interest charged by Inland Revenue, which is currently at the rate of 7 percent a year.

New trustee disclosure obligations

In 2013 the law commission was asked to review the Trustees Act 1956 and NZ Trust law generally. Following this initial review, nearly eight years later, the long-awaited "Trusts Act 2019" will finally come into effect on 31 January 2021, replacing the entire 1956 Act.

One of the most significant changes in the new Act that is generating interest from trustees and practitioners alike is the introduction of beneficiary disclosure requirements on trustees. This becomes sensitive if it means disclosing a trust's financial information, or to what extent some beneficiaries have benefitted more than others. However, the problem is what level of information should be disclosed and to whom?

Under the new Act, there are two layers to the disclosure obligations:

A "presumption" exists that Trustees will make available "basic trust information" to every beneficiary.

Basic trust information comprises:

- the fact the person is a beneficiary of the trust,
- the name and contact details of the trustees,
- any changes to the trustees as they occur,
- their right to request a copy of the trust deed, and
- their right to request trust information.

A beneficiary may request additional "trust information".

"Trust information" has a wide definition and includes information regarding trust property. Although, it specifically excludes "reasons for trustees' decisions". It is reasonable to assume 'trust information' includes financial information, but how detailed that information has to be is unclear, e.g. does it include amounts distributed to other beneficiaries? Given the new rules are intended to ensure beneficiaries have sufficient information to enforce the terms of the trust deed, it is presumed the answer is yes.

Before making "basic trust information" or "trust information" available to beneficiaries the trustees have to consider numerous factors, including:

- the personal or commercial confidentiality of the information,
- the age and circumstances of the beneficiary,
- the practicality of giving the information, and
- the effect on the beneficiary and family relationships of providing the information.

After taking all factors into consideration, the trustees can decide to withhold information from beneficiaries if they "reasonably" consider the information should not be provided.

The wording of the new Act is causing uncertainty and unease with existing Trustees as to what exactly their new obligations are and the risk of acting unreasonably. At one end of the scale, risk averse trustees are considering trust resettlements to establish new Trusts with a reduced number of beneficiaries, to preserve confidentiality or reduce the risk of litigation by beneficiaries. At the other end of the scale, trustees are awaiting case law to set the precedent on how to "reasonably consider" the factors above.

Although the legislation needs to be applied correctly (which in itself is uncertain), each situation is different based on the nature of family and beneficiary relationships, which makes it difficult to determine the best course of action.

New rules around feasibility expenditure

The Government is bringing in some new rules about claiming feasibility expenditure.

The rules are in the current tax Bill before Parliament. They are therefore not yet law and there could be changes.

If you abandon work on property, it's proposed you will be allowed to write off the feasibility cost as long as that property does not have a 0 percent rate of depreciation. This means if you abandoned a project on commercial property the feasibility expenditure will qualify because there are new rates of depreciation applying to this current year.

However, since residential rental buildings have a depreciation rate of 0 percent, you won't be able to take advantage of the new feasibility write-off.

If the total amount spent on a commercial feasibility study is $10,000 or less in any year, it can be treated as a tax deductible expense even though the project is not abandoned. Where the amount exceeds $10,000 and the project is abandoned, the cost has to be written off in equal instalments over five years starting with the year in which it has been abandoned.

A typical example of feasibility cost is a study of a proposal for earthquake strengthening.

Employee benefits for millennials

Say what you want about millennials, there is no denying their presence in the workforce. According to Statistics New Zealand, millennials (generally those born between 1981 & 1996) currently represent the largest age group in the workforce. Millennials are also attributed with having become problematic to attract, develop and retain - perhaps in part due to their unique preferences when it comes to employment benefits.

Generally, a work / life balance has always been among the top priorities for millennials, and while this remains true, the desire for work-life integration has emerged. Instead of disconnecting from work completely, millennials welcome the idea of mixing work and play, viewing social activities with co-workers as a resounding perk of employment. This is likely connected to millennials preferred work style, where they are less likely to work longer hours than other generations and embrace flexible ways of working. It is evident that millennials want flexibility and reject the premise that working long hours and being visible is the primary way to demonstrate value. Millennials are known to work well with clear instructions and targets, hence believe the where and how a job gets completed becomes less relevant.

Nevertheless, they are a generation that is committed to their personal learning and development. Research conducted by PwC revealed that 35% of respondents were attracted to employers who offered first class training and development programmes, with the most valued training opportunity being the ability to work with strong coaches and mentors. The study further revealed that millennials crave feedback, with only 1% of respondents saying feedback was not important. Millennials tend to favour frequent feedback sessions and value immediate on the job coaching. Whilst it may be difficult for older managers to navigate this expectation, millennials view the feedback cycle as integral to understanding how their role fits into the wider organisational strategy.

Millennials also lead the way in their desire to work for a company that reflects their own values. The Deloitte Global Millennial Survey 2020 revealed that 56% of respondents had previously ruled out working for an organisation because of its values, and 82% agreed that they were more likely to stay in a job if their personal values aligned. But what exactly do millennials value in an organisation? Putting employees first, having a strong foundation of trust and integrity, practicing customer care, and being environmentally and socially responsible are among the top ranking.

In order to motivate millennials, it is important that businesses understand what they can do to attract and retain them. Whether that be allowing them to work more autonomously, or encouraging learning and development, the reality is the turnover rate among millennials is still likely to be higher than other generations, in large part due to their willingness to quickly move on from organisations that do not meet their ever-changing expectations.

Changing use of car brings GST trap

Suppose you buy an expensive car for your business and you estimate 75 percent of the use will be for business and 25 percent will be private.

You keep the car for 10 years and then you take it over privately. You will then have to give back all the GST you have claimed. Using very extreme figures, shall we say your original GST claim was $30,000 (a somewhat expensive car).

You now have to pay back to the Inland Revenue $30,000.

Contrast this with selling the car, which may be worth $3000. You would only have to pay the Inland Revenue its share of that amount. Strangely, the system works in reverse. Suppose the car becomes 100 percent business use then the effect of the adjustment is to allow the full amount of GST on the original cost.

The Government is looking into this and changes are expected in the New Year. It may pay to wait, if you are thinking of taking your car out of your business for private use.

Be cheeky & seek out the best

One piece of business advice might be the only one you need.

It's this: Get cheeky and ask a smart, successful person for help.

Most people who have succeeded in business are happy to help someone genuinely seeking advice. In fact, they sometimes wonder why no one will talk to them. They're a bit like the best-looking ones at the dance who seem too good to be true, so no one asks them to dance.

We know of one local retired businessman who built a multimillion-dollar business with offices on every continent. Being semi-retired, he now helps all sorts of businesses to get where they want to be, or just get out of difficulty.

And the best part of it – he doesn't charge for his time. He loves the collaboration, but if someone doesn't want to take his advice, he's happy to walk away.

"It's their business, so it's their decision," he says. "I might not agree and I'll argue my case, but if they decide to do something else, that's fine.

"Because I don't charge, there's no obligation on either of us."

If you do your homework, you'll know who's been successful in your line of business. Seek out the best and ring them, or make an appointment to see them. It's never difficult to find well-know people. Be creative.

They might be retired and spending most of the time in the garden, but they'll have plenty of expertise and experience just waiting for someone to tap into. In fact, they might just be flattered that you have thought of them.

If you do get that phone call or appointment, be prepared. Be specific. What is your particular issue – starting in business, difficulty building the business, wanting to get out of the business . . .? What do you want from them? If they are good enough to give you their time, show you are prepared and won't waste the opportunity.

You never know, you might just build a strong business and personal relationship that benefits you both.

TAX CALENDAR

January 15
Second instalment of 2021 Provisional Tax (March balance date except for those who pay Provisional Tax twice a year)
Pay GST for period ended 30 November 2020

April 7
Terminal tax for 2020 (March, April, May and June balance dates)
For all clients except those who have lost their extension of time privilege

Get meeting notes as they happen

The use of Zoom and other online meeting platforms during the Covid-19 lockdown has spawned many innovations as companies scramble to change their work practices.

One clever innovation involves enhanced meeting notes.

In "the old days", notes were taken by a secretary, transcribed and delivered to participants when someone decided what should and should not be in them. Now it's possible to have a meeting in which everyone gets notes of the conversation as it happens.

One of these note-taking programs is Otter.AI, which has recently signed a deal with Zoom to put the notes into a web browser for everyone in the meeting.

The transcript can be copied at the end.

Meeting collaborators, such as teacher assistants or secretaries, who are logged into Otter can even highlight, comment, and add photos to create meeting notes that everyone can review and share.

The program is timely given many people are working from home. Many meetings, events, and classes have gone virtual, but remote workers and students struggle to listen and pay attention while having to take their own notes.

Businesses, schools and others can now capture information accurately and make them accessible instantly.