Harvie Green Wyatt
CHARTERED ACCOUNTANTS

Newsletter

SUMMER 2024

IR's long-term insights briefing

Inland Revenue has commenced consultation on what topic should be covered in its next Long-Term Insights Briefing (LTIB). Inland Revenue, like other government departments, is required to produce a LTIB once every three years.

The purpose of an LTIB is to identify and explore long-term issues to help plan for the future. Initial work has noted that New Zealand's tax revenue is just below the OECD average – 33.3% of GDP compared to the OECD's 34.2%. The means by which New Zealand's tax is generated differs from other OECD countries as follows:

- no compulsory social security contributions,
- no tax on capital gains,
- higher comparative tax revenue generated through GST,
- higher company tax rate,
- high effective tax rates on inbound investments, and
- higher than normal revenue from local government rates.

The proposed topic is "Our tax system: Bases and regimes". This will focus on two key aspects:

1. How to maintain a tax system with a stable core structure that can flex to changing revenue needs (such as due to an aging population).
2. How to address the current tensions within the tax system – integrity versus efficiency versus equity.

Both aspects become important if there is the need to increase revenue. Income tax is New Zealand's largest revenue source and increasing income tax rates could generate substantial revenue. However, raising income tax, especially for high earners, could discourage investment and economic activity. It may also prompt tax avoidance and reduce foreign investment, as New Zealand's current corporate tax rate is already higher than the OECD average.

Increasing the GST rate is another possibility. New Zealand's GST is already broad-based and effective in raising revenue, contributing more to GDP than many other OECD countries. Raising GST further would disproportionately impact lower-income households, as they spend a larger share of income on goods and services. This could exacerbate inequality, making the option an unpopular route unless offsetting measures are introduced to protect vulnerable groups.

Both options, raising income tax and GST, could provide immediate revenue boosts, but they can come with challenges.

Another option is to introduce new tax policies, with a comprehensive Capital Gains Tax (CGT) being the most discussed. Currently, New Zealand does not tax capital gains on asset sales, except in specific cases like the bright-line test on property sales. This hints at the renewed possibility of a CGT as a way to diversify New Zealand's tax base and ensure that wealth accumulation is taxed similarly to wage income.

As fiscal pressures grow, New Zealand needs to decide whether to raise existing tax rates or introduce new tax policies to meet its future needs. Both options come with significant trade-offs, and the decision will shape the country's economic landscape for decades to come.

Merry Christmas

The Team at Harvie Green Wyatt would like to wish all our clients a Merry Christmas & a Happy & Safe New Year!

Our office is closed from 5pm Monday 23rd of December and will reopen at 8am Monday 13th January 2025.

Extra pay when employment ends

From 1 April 2025, it is proposed to have a new way to calculate tax when someone leaves your employment. Employers will determine the tax based on the amount of the extra pay and the annualised amount of PAYE income payments received over the last two pay periods.

This is how it works:

Amount of the extra pay: This is the total amount of the extra payment.

Annualised amount of PAYE income payments received over the last two pay periods: This is the total PAYE income the employee received in their last two pay periods, annualised. Annualising means multiplying the total income by 52 (number of weeks in a year) and dividing by the number of weeks in the two pay periods.

Here's a simplified example:

- **Employee's last two fortnightly pay periods:** $1500 each
- **Annualised PAYE income:** ($1500 + $1500) x 52 / 4 = $39,000.
- **Extra pay:** $15,000.

The total is $54,000 ($39,000 plus $15,000). You will find the tax rate on $54,000 will be 30%. This is therefore the tax rate which will apply to the $15,000.

ACC will also need to be deducted so find the tax tables which include ACC.

Law change for family boost - people receiving schedular payments

The FamilyBoost scheme has run into a snag. Some people receive income in the form of schedular payments. The gross income is being used by Inland Revenue for assessing entitlement to FamilyBoost and the department realises this is wrong because no expenses are deducted from the income. For the six months from 1 October 2024 to 31 March 2025, the Commissioner proposes to treat income subject to schedular payments as exempt income for the purposes of FamilyBoost (see draft consultation document). The law is to be amended to cater for schedular payments.

The depreciable asset

The depreciation rate for non-residential buildings has been reduced to 0%, effective from the 2024 / 25 income year. However, commercial fit-out remains depreciable. This makes the distinction between the two important because it is the difference between not being able to deduct any depreciation at all versus being able to claim a good proportion of a building's cost as 'fit-out'.

Inland Revenue has recently issued a draft interpretation statement that provides essential guidance on how to correctly identify what the asset is for depreciation purposes. The guidance can be used for the purpose of identifying components of fit-out and depreciable assets generally. At its core, depreciation is an allowance for the loss in value of a capital asset as it is used to derive income. An asset's correct depreciation rate is a function of its estimated useful life and the industry in which it is used.

The legislation treats property as depreciable and therefore it is important to isolate separate items of property to depreciate them independently. The following indicators serve to ascertain whether an item is considered separate property or not.

- Is it physically distinct - can the item be separated based on its physical characteristics such as location or size?
- Is it functionally complete - can the item function on its own? However, this does not necessarily mean that the item must be capable of independent use or be self-contained.
- Does the item vary in function from another? The item remains separate where one item varies the function of the other, rather than combining to form a larger unified item.

Items are not required to be applicable to all three indicators as it always comes down to a matter of fact and degree. Identifying the relevant item of property can be straightforward in many cases but challenging in others.

The draft interpretation statement provides the example of a vehicle and a trailer, giving several reasons why they are treated as separate items of property for depreciation purposes.

Firstly, they serve different functions: the primary purpose of a vehicle is to transport people, while a trailer is designed to carry cargo. The trailer is used to transport items that cannot be suitably carried by the vehicle, acting as a supplementary addition, rather than an integral part of the vehicles function. Additionally, the vehicle is functionally complete and can operate independently of the trailer. Although a trailer cannot transport cargo without being towed by a vehicle, it is still considered functionally complete as it contains everything necessary to fulfil its role as a trailer. Therefore, for depreciation purposes, a trailer and a vehicle are regarded as separate items of property.

By understanding and applying these principles, businesses can achieve accurate tax compliance, avoiding the risks of under or overclaiming depreciation. Once finalised, the new interpretation statement will provide comprehensive guidance on the identification process for separate items of property, ensuring that depreciation deductions are correctly claimed.

The LTC Option

If a company sells a capital asset (e.g. commercial land) and derives a non-taxable capital gain, it's reasonable to expect the shareholders to want access to the cash. However, the problem often arises that in order for a capital gain to be distributed tax-free, the company needs to be wound up. This is a result of the fact that if a capital gain is distributed in the absence of a wind-up, the distribution comprises a taxable dividend.

Winding-up a company is not always desirable or the most practical route because it may own other assets or otherwise serve a purpose that means it needs to stay in existence. This can mean the capital gain becomes 'trapped'.

Enter the look-through company (LTC) to save the day. An LTC is legally an ordinary company, that elects to be treated as a partnership for tax purposes. As such, the income, expenses, tax credits and losses of the company are attributed to the shareholders based on their ownership percentage.

Just as important in this situation, dividends paid by an LTC to its shareholders are ignored for tax purposes. Hence, electing for a company to be an LTC is an option to enable a capital gain to be extracted tax free. But this gives rise to the question, is this tax avoidance? This exact question was recently covered by Inland Revenue in Technical Decision Summary 24/16 (TDS) issued in August 2024. The TDS notes:

The Applicant's decision to elect into the LTC regime was to allow the shareholders to retain

administrative and financial reporting simplicity, while also allowing tax-free capital gains (e.g., from the sale of assets) to be paid out to the family without requiring the liquidation of the Applicant.

It was acknowledged that the LTC rules clearly provide for a company to be treated as transparent as intended by Parliament. Therefore, Parliament would consider that the tax treatment of the arrangement is consistent with Parliament's purpose and is therefore not tax avoidance.

It is important to note that the TDS did state that it is a summary only, and does not include various facts or assumptions and hence cannot be relied upon. However, it would be unusual for Inland Revenue to release the TDS without a stronger comment to the contrary if the LTC option was not acceptable for this purpose.

However, the LTC option is not perfect. A tax cost to enter the regime can apply, calculated based on the company's retained earnings. There are also a number of criteria that need to be satisfied, such as it needing to have five or fewer 'look-though counted owners'; which itself can be complex to confirm.

That being said, it is an option to have 'in the back pocket' if the need arises.

Trusts - The big picture

For some, the increase in the trust tax rate from 33% to 39% has prompted them to ask the question – should we wind up our trust?

Rather than looking at the purpose of having a trust with a narrow tax lens, it may be of benefit to consider your circumstances more broadly and ask whether it is time to actually alter and even increase the role of your trust.

A trust provides a number of benefits such as asset and relationship property protection, succession and a way to manage complex family relationships. So instead, it may be worth asking:

Do you have the right trustees, both now and on your passing.

What happens on your death (is your will up to date), should the trustees change if you pass away.

Who should benefit under the trust, in what proportions and is that recorded.

If you make a distribution to your adult children and their relationship breaks down what happens – are risks mitigated.

In what circumstances should the trust be wound up.

A will sets out how your assets should be dealt with in the event you pass away. A trust can survive beyond your death, hence it is important that they continue to function and operate as you intend - and it is better to sort this while you're here.

Overseas pensions

There are tax complications when a taxpayer wants to transfer a pension scheme from overseas to a New Zealand scheme. Before embarking on a transfer of this nature, get advice. If the scheme is being transferred from the UK to New Zealand, two taxes can be levied. The latest Tax Bill proposes to allow the taxpayer to use the New Zealand scheme to pay the tax. This would apply only to transfers of funds and not to any tax on withdrawal of funds. Previously, the taxpayer has had to find the money, personally, to pay the NZ taxes and if they used the money from the fund that would trigger a UK withdrawal penalty if they weren't retirement age. If the scheme pays the NZ tax then that isn't seen as a withdrawal by the individual in the UK, which fixes the problem. The Bill also proposes to allow people under the age of 16 to be enrolled in KiwiSaver if one of their guardians contracts directly with the provider in the name of the young person. This is expected to come into effect from 1 July 2025.

Get creative with AI

One of the most used AI tools for small businesses is creative writing. That's because business people don't necessarily make great writers.

So how is AI being used? Think about what writing you do through the day. Maybe as a builder, for example, you don't think you do a lot of writing. But:

- You have to write emails to prospective clients, saying how good you are.
- You will occasionally have to reply to an unhappy client.
- You will need to write the words for an advertisement or flyer.
- You will need to keep your website or social media page up to date.

Once you start using AI writing tools, you'll find all sorts of other uses. But always remember, AI is not you. If the words AI spits out don't reflect your true personality or faithfully reflect your business brand, people who know you will be wary. Check everything before you press 'Send'.

How can AI help? – just ask it

AI is here for good, but most small and medium businesses (SMEs) in New Zealand are still reluctant to adopt it.

The reasons: not understanding how it can be used, and little appreciation of its value to a business. However, some business pundits are suggesting those who adopt AI now will gain the most in years to come.

The reality is that AI can make a valuable contribution to your productivity. So how else can it help your business?

There's a simple answer – ask AI. Be as detailed as you can about your business in your questioning. You might be a retailer, but you sell imported giftware in the city. You might be a plumber, but your specialty is drain laying in rural areas.

There are lots of AI programs to choose from, so just search online: "Ask AI a question". You might be surprised at the answers.

FBT and home to work travel

A common complaint made by employers is that the amount of time it takes to meet their FBT obligations is disproportionate to the amount of tax it actually generates. This frustration is arguably borne out in the number of mistakes that are often made when calculating the amount of FBT payable. A good example is employers taking the view that an employee's home is a place of work and therefore FBT does not apply to the use of a company car to drive to and from work.

Inland Revenue has been working on a new interpretation statement that provides guidance on the treatment of home to work travel. It covers topics such as whether taking a vehicle home for charging or security reasons is sufficient to conclude that FBT does not apply. For the purpose of these two examples, the conclusion is that FBT would still apply, which hopefully does not come as a surprise.

The guidance is expected to be finalised shortly. Current treatment should be confirmed based on the guidance once released. However, in line with the original complaint, the draft statement is over 50 pages long and is likely to only reinforce the conclusion that maybe Inland Revenue's resources should have been put into how to simplify the regime instead

TAX CALENDAR

28 November 2024

First instalment of 2025 provisional tax for those with June balance dates.

15 January 2025

Second instalment of 2025 provisional tax (March balance date except for those who pay provisional tax twice a year)

Pay GST for period ended 30 November 2024

7 April 2025

Terminal tax for 2024 (March, April, May and June balance dates).

IRD rules on salary sacrifice for low-cost commute

A company called WorkRide provides self-powered or low-powered commuting vehicles like scooters, e-scooters and e-bikes.
It has obtained a ruling from Inland Revenue, which relates to the employee accepting a salary sacrifice so that he/she gets ownership of the vehicle at the end of the contract.

The department has ruled:

- The arrangement will not be a fringe benefit.
- The amount of the salary sacrifice is not a PAYE income payment.
- The scheme will not be tax avoidance.
- The employer can claim the GST charged on the supply of the services by WorkRide being the facilitation of the arrangement.
- The salary sacrifice is consideration for a taxable supply by the employer to the employee. The value of the supply is the amount of the salary sacrifice.

Common courtesy wins a client

A client recently needed some plumbing work done. Her usual plumber said he was "too busy" and wouldn't say when he'd be available.
Since the job was fairly urgent, she called another plumber, a young guy eager to grow his business. They exchanged a few texts, figured out what needed to be done, and set up a time that worked for her.
He got delayed on the way, but what he did next pretty much guaranteed him a lifelong customer. He called to let her know he'd be a bit late but would be there soon, and he arrived less than 10 minutes later.
The client wasn't bothered by the delay at all. In fact, she told the plumber she was impressed he took the time to call. He seemed a bit puzzled and said, "That's just common courtesy, isn't it?"
It is common courtesy, but it's often overlooked these days. Courtesy won this plumber a new client, while a lack of it cost the other plumber valuable business.

IRD - Changes to credit and debit card payments

IRD are changing their third-party vendor used for credit and debit card payments.
From 1 November 2024, you will no longer be able to make online card payments using IRDs website without logging in.
Customers can still make card payments in myIR or over the phone.

There are also other ways of paying, which include:

Paying electronically
Internet banking with direct credit payments, setting up and making direct debit payments in myIR and using automatic payments with your bank

Paying by phone
You can make a credit or debit card payment using IRD self service phoneline

Paying from overseas
Setting up and making direct debits in myIR, or by making international money transfers through your bank

Paying at Westpac
You can make a cash or eftpos payment at any Westpac branch or Westpac smart ATM. When making a payment you will need to identify yourself by providing your name. You will also need your return or statement barcode or you can create your own on the IRD website.

Undercharging a recipe for disaster

We all know most businesses fail within their first five years.
There are many reasons, but one of the most consistent issues, especially for new business owners, is pricing. It's a tricky area, with the huge temptation to underprice the market to get new business.
That strategy is a recipe for disaster. Undercharging is universally recognised as the biggest, most common and most dangerous mistake in business. One business adviser says very few people overcharge, but he estimates 90 percent undercharge.
The forces that push businesses into liquidation work both ways. The business owner might be producing a great product but doesn't appreciate how good it is, so it's sold cheaply. Chances are the customer also doesn't appreciate its value because it's cheap. Often, the higher your price the more you will be perceived as good at your job!
A Wellington entrepreneur once said: "Set your price to the point of resistance." In other words, your customers will tell you if they think you've overshot your pricing. But more often than not, you'll not be charging enough.
If you raise your prices by 10 percent, your income might even double because the extra charge is all profit. For example, sales of $500 provide a profit of $50, but the profit on sales of $550 is $100.