

IRD Compliance Focus Report for 2011-2012

Although most individuals and businesses voluntarily comply with their tax obligations, there are those who don't comply. One of the objectives of the compliance focus is to ensure that people pay and receive the right amount of tax and the IRD has shifted its compliance strategy plans to address this. Previously, they have looked at patterns of non-compliant behaviour by customer groups, e.g. individuals, families, small and medium enterprises (SEMs) and employers. This has now shifted to four key themes:

- \$ *To provide certainty to their customers* – in case errors have been made, then the process to fix it is laid out thereby giving certainty;
- \$ *To receive the right information at the right time* – so any entitlements to claim are made at the right time;
- \$ *Everyone files and pays on time* – so they meet their tax obligations to register, file, report and pay on time; and
- \$ *Everyone receives and pays the right amount* – this takes into account various areas of activities as stated below.

To ensure that people pay the right amount of tax, the IRD will look at:

- \$ Aggressive tax planning e.g. adopting a particular structure or arranging tax affairs to gain a tax benefit;
- \$ Under-reporting e.g. having overseas bank accounts where income earned from it is not reported;
- \$ Diversion of income to claim Working for Families Tax Credits or other such benefits;
- \$ Operations outside the system e.g. businesses trading online or cash operations and not declaring that income; and
- \$ Continuing to target those businesses:
 - taking part in the hidden economy;
 - in the hospitality and tourism trade;
 - property developers, speculators and dealers earning income from property transactions;
 - that need improved compliance such as agricultural or horticultural industries.

If you think you may be a target due to the IRD's Compliance Focus strategy then you may want to contact your advisor.

Kiwisaver Changes

The three key changes that have been legislated are:

- 1) The Government's contribution has reduced from \$1,042 to \$521 maximum per annum beginning 1 July 2011 year. However, in order to get the \$521 contribution one still has to save \$1,042.
- 2) The minimum level of employee and employer compulsory contribution rates has increased from 2% to 3% from 1 April 2013.
- 3) The employer contributions will be taxable from 1 April 2012. Up until this point the compulsory employer contributions of 2% were tax free, but from 1 April 2012 anybody on the top tax rate of 33 cents in the dollar will actually get only 67% of their employer's contributions paid into Kiwisaver.



Employer Contributions

Compulsory employer contributions to KiwiSaver schemes are complying funds and are currently exempt from employer superannuation contribution tax (ESCT). A complying fund is a section within a registered superannuation scheme that has incorporated certain KiwiSaver rules – in particular portability and lock-in. Any voluntary employer contributions to KiwiSaver schemes are subject to ESCT. Voluntary employer contributions include contributions you make:

- Over and above the compulsory employer contribution rate;
- To employees aged under 18 or over 65 years (and who have been a member for more than five years);
- To employees on a contribution holiday; or
- To employees who are on leave without pay.

Asset Sales between Associated Parties

Time again, taxpayers get caught under the associated party rules even when there is a genuine business transaction between the two. For example, where a company is expanding and restructures to house different business streams in different companies which will entail selling assets to the newly formed company; or more commonly, where farming parents are retiring and sell their farm assets to their son/daughter's new entity. In such situations, the parties will be 'associated persons'.



Issue with GST

Where a transaction is between associated parties, the purchaser can claim GST input tax on the **lesser** of:

- The GST component (if any) on the original cost to the supplier;
- 3/23 of the purchase price; or
- 3/23 of the open market value.

So in our first example, if the market values of the assets sold to a related entity are less than the purchase price, the purchasing company will be able to claim GST input tax on the lesser amount while the selling company will have to return GST output tax on the higher sale price. The net result for this group of companies is that it will be out of pocket while still owning the same assets. The situation could be worse if say in the second example for instance, the parents inherited the farm assets or purchased them before the introduction of GST legislation in New Zealand. The GST component on the original cost to the vendor will be zero which is the lesser of the three values above and, therefore, the purchasing entity will not be able to claim any GST!

Other Tax Issues

The ITA 2007 (section EE 40) limits the depreciation base for the purchaser as well. The purchaser can depreciate the assets of the **lesser** of:

- The purchase price of the assets to the purchaser; or
- The (original) cost of the assets to the vendor.

Taking the farming situation above, if the farm assets are sold at (higher) market values the purchasing entity will not be able to depreciate them at the market values but instead at the original cost of the assets. In addition, the vendor will have depreciation recovery which will be taxable. To illustrate this, let's say the original cost to the parents of a shed was \$10,000 which has a depreciated book value of \$5,000 but the market value on date of sale to their son's entity is \$20,000. The parents will be taxed on depreciation recovery of \$5,000 while the son's entity will be able to depreciate the assets only on \$10,000 (although \$20,000 purchase price is paid). Section EE 40 is an anti-avoidance section designed to stop an associated party from selling at an inflated price to make a huge (tax free) capital gain and to stop the purchaser from using an inflated price to depreciate an asset. Unfortunately, the section also catches unintended genuine transactions, as can be seen from above. This problem can be overcome if the taxpayer makes an application to the IRD requesting it apply its discretion to allow the taxpayer to use the actual purchase cost as the depreciation base. The IRD will look at certain factors on a case-by-case basis before it exercises its discretion. If you believe you are in such a situation, you are best to contact your advisor.

Tax Talk Let Us Entertain You

Let's look at the tax treatment of saying thanks to customers and staff typically with gifts, wining and dining. Inland Revenue's IR268 guide gives the following examples of where entertainment expenses are 50% deductible:

- ✧ Taking customers, suppliers and business associates out for dinner or putting on a function for them
- ✧ The traditional Christmas party for staff
- ✧ Shouting customers, suppliers and staff to an event, e.g. a rugby game or a show
- ✧ Taking them on a jaunt in your launch (running/hireage costs and goods and alcohol)
- ✧ Giving them the use of your bach or time share apartment as a thank you gesture (the occupancy costs)

We've been asked 'why only 50% deductible?' Apparently it's because we get some personal enjoyment or benefit from quaffing a wine and tucking into a steak (too right!).

In lieu of a Christmas party you may give your employees restaurant vouchers to use at their discretion. This cost is fully deductible but is subject to Fringe Benefit Tax (FBT), although there is an exemption of \$300 per employee per quarter (a maximum exemption can apply).

The same treatment applies to staff gifts, again fully deductible but subject to FBT under the 'other benefits' category.

As a thank you gesture many firms give their customers gifts during the festive season. The cost of the gifts is fully tax deductible as marketing and promotion expenditure.

Risk & Reward Holiday Pay – Best Practice

Kiwi businesses, especially those involved in contracting and service industries, often close for annual holidays just prior to Christmas and reopen in the New Year. Many businesses encourage their staff to take leave over the festive season 'when things are quiet'. Staff employment agreements will include provision for staff to take at least part of their annual leave during this close-down period. The calculation of holiday pay is an integral part of employees' final pay for the calendar year.

Employees are entitled to receive their pay for annual leave before they commence their leave. This provision provides an employee with money to pay for travel and accommodation.

The employer and employee can agree to leave the normal pay cycle undisturbed by the time off work. If so, it's recommended that the employees' employment agreements reflect this.



Year End Computer Detox!

By December most computers are feeling the effects or over-indulging. Perhaps not on Christmas wine and chocolate but as the result of viruses, document hoarding and other accumulative hangovers. Detox your computer to get it working faster, safer and more efficiently.

- ✔ Clean it. Literally. You'll be amazed what appears when you tip that keyboard upside down (only use anti-static wipes or a soft brush. NOT water!)
- ✔ Remove clutter, delete unwanted documents off the desktop and tidy up your folder structure.
- ✔ Remove any programs that are no longer required.
- ✔ Make sure your firewall is active.
- ✔ Perform a last minute virus scan.
- ✔ Perform a disk cleanup and disk defragmentation (set this run overnight as it may take several hours).
- ✔ Perform routine backups of all files and settings.
- ✔ Archive files offsite.

Calculating Annual Holiday Pay

Whichever of the following is the larger becomes the rate of the weekly holiday pay:

1. **'Average weekly earnings'**: Calculate 'total gross earnings' for the 12 months before the end of the last pay period before the annual holiday and divide this figure by 52.
2. **'Ordinary weekly pay'**: Multiply the ordinary hourly rate of the employee's pay as at the start of the holiday by the number of hours worked in a 'normal' week.

Calculating Pay for Statutory (Public) Holidays

1. **'Relevant daily pay'**: Find the amount of pay that the employee would have received if he or she had worked on the day concerned.
2. **'Average daily pay' is used when relevant daily pay is not possible or practicable or there is variation in the daily pay during the pay period when the holiday occurs.** Calculate gross earnings for the 52 weeks before the end of the immediately preceding pay period and divide by the number of whole or part days during which the employee earned those earnings including days of paid holiday or leave.

In the case of employees who have commenced employment during the year, their average weekly earnings are calculated by taking the amount of their gross earnings from starting work until the last pay period before the holiday and dividing that amount by the number of weeks worked. For examples on holiday pay visit the Department of Labour's website: <http://www.dol.govt.nz/>

Pay calculations can be complex especially when employees receive allowances, (eg. travel) and have deductions made (eg. Kiwisaver, student loan) so contact us if you need assistance in getting these important calculations right.

Book Out Your Bach: Avoid The Tax Headache



Recent years have seen a surge in popularity in the short-stay rental of holiday homes. The internet has made it easier to list, book and review baches and cribs which are available when owners aren't in residence.

Inland Revenue have recently issued a paper proposing new rules on mixed-use assets (including holiday homes) where there is a mixture of business and personal use, with revised criteria that should be adhered to when booking out the bach. But until the rules are formally changed, the current policies still apply.

Firstly, it's vital that your intentions are bona fide. You must market the holiday home in a commercial manner such as setting up and using a website for the property, registering the property with a reputable holiday home website or listing the property for short stay rental with local real estate agencies. These efforts cannot be seen to be 'token', you should be accepting offers from suitable renters.

Secondly, your own (plus family and friends') use of the property must be diarised so you can determine the days in a year that the property was available for renting out.

If the property is owned by an individual or a family trust the expenses relating to the property including the utilities (power, rates, insurance), maintenance and interest on debt will be apportioned according to the number of days in a year the house was available for rent.

There are GST issues too. Short stay accommodation is a taxable supply for GST purposes so if the annual rent you are receiving exceeds \$60,000, the owning entity (individual, partnership, company or trust) is required to register for GST and return GST on the outputs (rent) and inputs (expenses and improvements) made and received.

This threshold may seem high but some do have more than one holiday home in the same entity! This threshold includes the market value of free or cheap use of the bach by persons associated to the owner.

The value of the property becomes a taxable supply when registration occurs and when the property is sold or the entity deregistered. Both the income tax and GST issues can be quite tricky so we recommend consulting us to make sure all the tax bases are covered correctly.



Seasons Greetings from us all

Footes Ltd will be closed for the Christmas break from 12 noon Friday 23rd December 2011 until Monday 16th January 2012



Disclaimer

This publication has been carefully prepared, but it has been written in general terms only. The publication should not be relied upon to provide specific information without also obtaining appropriate professional advice after detailed examination of your particular situation.

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