

## QUARTERLY NEWSLETTER



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## From The Managing Partner's Desk

<< Charles Worth

Welcome to our Spring Edition of CST Nexia News. Winter is behind us. We are looking forward to some much needed warmer weather.

We have recently welcomed new members to our CST team. Heather Hodgkinson joined as PA/marketing coordinator and Rachael Clarke as receptionist. We wish Sarah Stuart well as she departs for parental leave shortly.

The Supreme Court decision in favour of the Commissioner of Inland Revenue in the Penny and Hooper case has been making recent headlines. We have summarized the case below and will be keeping a close eye on developments following the outcome of this important case.

Our tax update on page four of this newsletter is full of important information for you and your business

regarding recent tax changes. If you require further information, please do not hesitate to contact our team.

As we head into September, the Rugby World Cup is dominating the headlines which will significantly showcase New Zealand. We wish the All Blacks success in bringing the Cup back to New Zealand. •

## Penny and Hooper Decision Finding in Favour of Commissioner Released

The long awaited decision of the Supreme Court was released on 25 August 2011.

The case involved orthopaedic surgeons who sold their businesses to companies owned by family trusts and of which they were the sole directors. They then paid themselves a salary significantly less than they were previously receiving which gave them tax savings of 6c in the dollar – being the difference between the company tax rate of 33c and the highest marginal tax rate of 39c. The balance of the profits was distributed by dividends to their trusts with tax paid at either 33c (trustee tax rate) or the beneficiaries' marginal rates.

Penny had established his structure prior to the introduction of the 39c rate but at the time the rate changed he reduced his salary and took the balance of the cash as a loan from the trust interest free (from funds the trust had received as dividends from the company operating the business).

The Commissioner contended that the arrangements were tax avoidance and assessed the taxpayers for an amount he believed to be a commercially realistic salary.

The Supreme Court noted that the structures adopted by the taxpayers were entirely lawful. This was a case in which it was possible to move straight to s BG 1 (tax avoidance) and ask whether the use of the structure which was adopted when the salaries were fixed was beyond parliamentary contemplation and resulted in a tax avoidance arrangement. The question to be asked is why the salary was fixed as it was on a particular occasion. Whether that involved tax avoidance can be answered by looking at the effect produced by the fixing of the level of salary in combination with the operation of the other features of the structure. They found that in reality the taxpayers suffered no financial loss of income but retained a reduction in liability to tax as if they had.

In conclusion, it was accepted that there was no concept of a commercially realistic salary to be found in the Income Tax Act. However the Act does require that taxpayers should not structure their transactions with a more than merely incidental purpose of obtaining a tax advantage unless that advantage is in contemplation of Parliament. If the salary is not commercially realistic or is not motivated by a legitimate (non-tax driven) reason it will be open to the Commissioner to assert that it was, or was part of, a tax avoidance arrangement.

In a press release issued by New Zealand Institute of Chartered Accountants ("NZICA") yesterday, the decision may well be tempered by the strong reliance on the Privy Council's decision in Peate and thus there is a limit to its wider application. NZICA will seek comment from Inland Revenue on this point.

So what does this mean for practitioners and clients? Structuring

*Continued over page.*

# Recent changes to Employment Relations and Holidays Act

Continued from page one.

a client's business affairs with more than a merely incidental purpose of obtaining a tax advantage may be considered tax avoidance. In setting an appropriate salary level we should consider whether the salary would be acceptable if paid in return for services provided to a third party.

If you have any queries regarding this case or how it may affect you we suggest you contact your CST advisor or email us at [team@cstnexus.co.nz](mailto:team@cstnexus.co.nz).

## Retention of individual employment agreements

From 1 July 2011 employers must retain a copy of every individual employment agreement, even where the employee has not signed the agreement. Labour inspectors can enforce these new requirements. However, they will give employers seven working days to correct any problems. If this is not corrected, the employer may be liable for a penalty. It is worthwhile noting that penalties have increased recently from

\$10,000 to \$20,000 for a company and from \$5,000 to \$10,000 for an individual.

## Cashing up of annual holidays

A reminder that from 1 April 2011 employees can now request that up to a week of annual holidays be cashed up. Employers can accept or decline requests and can even have a blanket policy that they will not cash up.

## Proof of sickness or injury

Also as from 1 April 2011 employers can now request proof of an employee's or dependent's sickness or injury within 3 days. However employers must pay for the costs of such proof, e.g. doctor's visit.

Given the toughening up of penalties it might be time to rethink your employment administration. For advice on maintaining a comprehensive employment file or any other HR related issue please contact our Human Resources Manager – Deirdre Little on 261-1392.

## Debtor Management is Important

With debtors' days outstanding being in excess of 54 days, debtor management has never been as important as it is today. If you are giving credit to your customers, then effective debtor management is very important:

- Ensure any payment arrangements with a debtor are confirmed in writing, including details of any key dates.
- Follow up with the customer to ensure that payments are made on the key dates.
- Review dealings with a private

company.

- Obtain individual directors' guarantees.
- Ensure tax invoices are prepared correctly in accordance with the customers'/clients' format requirements and sent to the customers'/clients promptly by the stipulated dates.
- Ensure follow up of customers'/clients' invoices from the due date to ensure prompt payment or, if the customer/client has a query, resolve the query as soon as possible.

- Monitor debtors' aged analysis on a weekly basis, calculate debtors' days outstanding and maintain your business' terms of trade (e.g. 30 days).
- If payment is not received, ensure prompt referral of problem debtors to a debt collection agency.
- Utilise a 'debtors' days outstanding chart' to identify the cashflow improvements that would occur if debtors paid in accordance with your stated debtors payment policy.



## Talk to us about shareholding changes

We've recently experienced cases where clients have decided to make shareholding changes in their companies, have gone online to the Companies Office website and Bob's your Uncle, shareholding changes updated!

Actually, it wasn't such a smart idea as it turns out. Changing shareholding in your company without talking to us first can have dire tax consequences. These consequences can be far reaching. Continuity of losses carried forward can be affected, imputation tax credits can be lost forever, and under the new Look Through Company regime the flow of losses will be affected.

Moral of the story? Talk to us when you're contemplating share changes. Even better, get us to be your Registered Office. In fact, we do this for most of our clients. We'll file your annual return for you, and we'll make sure you comply with all of your statutory records requirements under the Companies Act.

## Company tax rate down to 28c from 2011/12 tax year

Flowing from last year's budget the company tax rate will drop again from 30c to 28c (meaning we beat Australia at something – having a lower company tax rate). It is helpful to take this into account if considering making an estimate for

your provisional tax.

You will have a two year transition through to 31 March 2013 to use up your 30c imputation credits.

Please take care when calculating dividends and the imputation credits being attached plus the resident

withholding tax due to IRD – we saw clients make a few errors in this area upon the previous rate change.

We suggest you ask us to check your calculations before making payment to eliminate the potential for errors. ●



## GST changes

There have been some fairly major changes to GST from 1 April 2011, that may affect you.

### Zero-rating on land

In the past if you bought or sold land you may have zero-rated the transaction if it met certain conditions and was considered the supply of a "going concern". Otherwise the transaction would have been subject to GST.

From 1 April 2011, most transactions between two GST registered persons which include the supply of land will be zero-rated. This change has come about as an anti-avoidance mechanism.

The new rules include transactions wholly or partly consisting of land where the recipient is GST registered, the land is used for

making taxable supplies and is not a principal place of residence for the recipient or any associated person.

If, however, you entered into a transaction before 1 April 2011 and time of supply was triggered after 1 April 2011, the supplier has the option of choosing whether to apply the old rules. If the old rules are not elected the new zero rating provision will apply. Time of supply is generally triggered on an unconditional date where a deposit is paid for the benefit of the vendor.

We strongly advise that you discuss any proposed property transactions (or other major transactions) with us prior to entering into any agreements.

For agreements entered into from 1 April 2011 the new rules will apply. The vendor will obtain from

the purchaser their GST registration number and confirmation that the land will be used in a taxable activity. Given the new requirements and implications of getting it wrong we recommend you seek further advice if you are buying or selling land.

### Change in use

Do you currently make adjustments for private use of business assets or vice versa? If so read on...

The GST regime has been based on a principal purpose test where you may have claimed the full GST portion of an asset with a joint business and personal use. The change applicable from 1 April 2011 is to a true apportionment regime where you make an upfront claim to the extent of your anticipated usage rather than make an adjustment in

each GST return.

If you are currently making adjustments in each return there is a transitional period where you will continue to adopt the old apportionment rules. This period depends on the market or book value of the asset as at 1 April 2011. The maximum length of time you would continue making the adjustment for is 5 years (with the exception of land which continues indefinitely).

Please contact us if this applies to you and you prepare your own GST return as you will require more information to enable the appropriate adjustments to be made in future.

If we prepare your GST return, we may be in touch to obtain further details if these rules apply to you. ●

## Increase in IRD mileage rate

The IRD rate for reimbursing mileage incurred for business expenditure has increased from 70c per km to 74c per km.

You have the choice however of using a rate from a reputable independent NZ source such as the AA. ●

## Dividends paid to Non-Residents

We have advised you previously of changes in this area – where you may no longer be required to deduct Non-Resident Withholding Tax (NRWT) from dividends paid.

The changes affect NZ companies paying dividends to non-resident shareholders who own greater than a 10% interest in the NZ company. It also applies to those that own less than 10% where the post treaty tax rate would be less than 15%.

In these cases, if the dividend is fully imputed - the NRWT rate is zero.

In terms of your filing obligations – though the rate is zero you do still need to remain registered for NRWT and file the appropriate return forms recording the amount of the dividend paid (though the NRWT may be nil).

If you currently file your IR67P monthly you may wish to have this changed to yearly to save time/cost. We could help you with this if required.

Remember you do still need to complete the annual reconciliation and certificates. ●

“When you are through changing, you are through.”

~Bruce Barton



# Tax Update September 2011

<< Tania Styles

## Depreciation – what do all the changes mean for you?

As you are likely aware, there have been many changes affecting depreciation. Now that these are in effect it is timely to cover off the details so you understand how it will impact on you.

The main change is a 0% depreciation rate for most buildings (those with useful lives of 50 years or more) with application from the 2011/12 year (for those with a 31 March balance date from 1 April 2011).

The 20% loading on assets was also removed for those assets purchased after 20 May 2010. Assets purchased or constructed or where there was a decision to purchase or construct an asset before 20 May 2010 still qualify for the loading (i.e. there was a binding contract, or expenditure in respect of the purchase was incurred before 20 May 2010).

We have covered off more details under the headings "Commercial" and "Residential" below as well as common questions we have been asked.

### Commercial Buildings

Please note an amendment to the definition of dwelling – it now excludes a number of types of buildings that provide residential-type accommodation but are commercial in nature (e.g. rest homes).

As noted above no depreciation can be claimed on most buildings from the start of the 2011/12 tax year.

The change affects buildings with an estimated useful life of 50 years or more regardless of when the building was purchased.

Examples of buildings with an estimated useful life of less than 50 years that can continue to depreciate are barns, portable buildings, fowl houses and hot houses.

When you dispose of the building, your depreciation recovered is limited to the amount actually claimed (up to 31 March 2011).

Depreciation may still be claimed on the fit-out of commercial and industrial buildings at the applicable rate. If you now wish to obtain a valuation you could start to claim depreciation on items of fit-out going forward. There is a likely cost benefit of doing so as your increased depreciation deductions may outweigh the cost of a valuation.

If you have not split out items of fit-out you can claim an annual deduction of 2% straight line at 15% of the book value of the building. This is the new "pool approach".

When you dispose of an item in the pool - there is no impact on the pool nor any loss or gain recognised. You continue to get the 2% deduction of the 15% of the building's depreciated value until the pool is fully depreciated.

It is possible that the purchase of some items replacing items that were not separately depreciated (so effectively were in the pool) may qualify as repairs and maintenance (and be fully tax deductible). However, this would only apply in very limited situations and would require further consideration to determine the correct treatment.

Where you have acquired items of fit-out since acquiring the building, the total of the book value of these would be deducted from the 15% portion mentioned.

#### For example:

Building cost \$1,000,000  
Current book value 31 March 2011 \$600,000  
Further items of fit-out acquired since cost \$100,000  
Current book value of fit-out items \$60,000

#### Calculation of 15% pool:

Building BV \$600,000 \* 15% = \$90,000  
Less Fit-out BV \$60,000  
Pool \$30,000

Apply depreciation rate of 2%

NB: You may wish to take these changes into account if preparing monthly reports as your monthly depreciation accrual will be significantly reduced from the prior year.

### Residential Buildings

The change meaning that with no depreciation is able to be claimed on most buildings (those with useful lives of 50 years or more) from the start of the 2011/12 tax year also applies to residential buildings (such as rental properties).

In 2010 the IRD confirmed its position on the depreciation of items comprised in a residential property.

In Interpretation Statement 10/01 they clearly set out their interpretation of which items comprised building proper as opposed to being separate items of depreciable property.

As the statement is 53 pages long we have not reproduced it here but have summarized the key points.

The IRD applies the following (three step) approach to determine whether an item is part of

a residential rental property or a separate item of property:

**Step 1** Determine whether the item is in some way attached or connected to the building – for example is it completely unattached from the building, is it only connected by a plug or is it wired into an electrical outlet.

**Step 2** Determine whether the item is an integral part of the residential rental property such that the property would be considered incomplete or unable to function without it – if it is not integral go to Step 3.

**Step 3** Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the "fabric" of the building – taking into account the nature and degree of attachment and difficulty (and damage) involved in removal of the item.

We have categorized some of the common items below into either building or separate.

Building	Items to depreciate separately
<ul style="list-style-type: none"> <li>• Plumbing and piping</li> <li>• Electrical wiring</li> <li>• Internal walls</li> <li>• Doors</li> <li>• Fitted furniture such as inbuilt wardrobes</li> <li>• Kitchen cupboards</li> <li>• Bathroom fittings and furniture</li> <li>• Lino</li> <li>• Tiles (wall and floor)</li> </ul>	<ul style="list-style-type: none"> <li>• Freestanding wardrobes and cupboards</li> <li>• Carpet</li> <li>• Curtains and blinds</li> <li>• Water heaters and hot water cylinders</li> </ul>

This is a generalised summary and should not be relied upon without further detailed consideration. Please contact us to discuss your specific circumstances.

If you have previously only claimed depreciation at the building rate, you may wish to consider obtaining a valuation for the items that can be separately depreciated. Depending on the cost of a valuation, there could still be a net cost benefit of doing so, though the level of depreciation claim will depend on the age of the depreciable chattels (for example, if they are very old and therefore have a low value on which to depreciate going forward).

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