

NEWSLETTER

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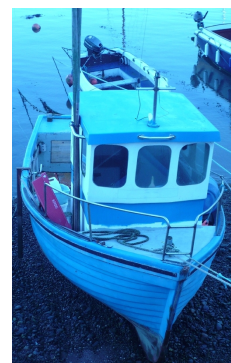
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NEW LEGISLATION FOR MIXED-USE ASSETS

The Government has introduced a Bill into Parliament that will limit taxpayers' ability to claim a tax deduction for costs associated with mixed-use assets, i.e. assets that are used both privately and rented to third parties, for example bachs and boats. When enacted, the new rules will apply from 1 April 2013. The new rules apply to an asset used partly to derive income and partly for private use if it is:



- not used for at least 62 days in an income year,
- is land or an asset with a cost of more than \$50,000,
- held by an individual, partnership, trust or close company, and
- not a motor vehicle, or an asset whose expenditure is apportioned for tax purposes on the basis of floor area, etc.

"Private use" is defined as use by the owner or an associated person or use by a third party for less than market value.

Broadly there are three categories of costs:

1. costs that provide a solely private benefit that are not deductible,
2. costs that provide a solely income earning benefit that are deductible, and
3. the balance that is apportioned between the period the asset is used to derive income and the period it is used privately, as per the formula below:

$$\text{expenditure} \times \frac{\text{income-earning days}}{(\text{income-earning days} + \text{private days})}$$

Income earning days are defined as the days in which the asset earns a market value rate of income or above. All other days the asset is in active use are classed as private days (i.e. when the asset is in use by the owner or if it is rented out at below market rate). For example, if a taxpayer's holiday home is rented for

five weeks and used privately for five weeks then the costs, which provide neither a wholly private or income earning benefit, are 50% deductible.

Additional complexity does exist as there are specific rules around the apportionment of interest costs on borrowing and GST.

Losses are unable to be offset against other income and are instead offset against future income from the asset, if the gross income derived from renting the asset to non-associated third parties is less than 2% of:

- in the case of land, the latter of either the most recent rating valuation or cost at acquisition, or
- for other property, the cost of the asset to the taxpayer.

Taxpayers will also have the ability to opt out of the rules if the income from an asset is less than \$1,000 in an income year. If a person opts out of the rules the income is treated as exempt income and not subject to tax.

With 1 April 2013 not so far away, it would be prudent to think about how these rules may apply to any mixed-use assets you own and what record keeping processes you may need to introduce.

TAX TREATMENT OF EMPLOYEE ALLOWANCES

In an effort to reduce uncertainty regarding the tax treatment of employee reimbursements and payments for meals, accommodation, communication and clothing, the IRD released an officials' issues paper in November 2012. The IRD is seeking feedback on proposals to introduce legislation specifically pertaining to these types of expenditure.

MEALS

- **Employee meal costs when travelling for work** - tax-free if duration of travel to a given location is less than three months, otherwise taxable in full for longer trips,
- **Meal expenses (not during travel for work)** - tax-free provided payments are not made on a regular basis or as a reward for employee services.

ACCOMMODATION

- **Cost of employee accommodation when travelling for work** - tax-free if duration of work travel to a particular work location is less than 12 months, with a discretion for travel in excess of 12 months in exceptional circumstances - taxable in full for longer trips,
- **Cost of accommodation provided as part of employment, e.g. farmhouse** - No change - the market value of accommodation to be treated as taxable,
- **Employees who work from home** - No change - market value of accommodation is taxable,
- **Cost of accommodation (more than one permanent workplace)** - Factual assessment of the principal place of work to be performed i.e. based on time spent. Accommodation payments for the second workplace may be tax-exempt,
- **Cost of accommodation (employees seconded overseas)** - Treat as taxable up to the market value of equivalent accommodation in NZ, e.g. a similar property with the same number of bedrooms.

COMMUNICATION

- **Payment for employee's communication costs (including telephone and internet)** - Taxable in full except where the private/work portion is able to be separately identified.

CLOTHING

- **Cost of clothing for employees** - Taxable unless the clothing is necessary and peculiar to the employee's occupation e.g. uniforms, protective or specialist clothing.



On a related topic, in December 2012 the IRD released a statement (CS 12/01) that has caused some concern. The statement outlines the IRD's view on accommodation allowances and accommodation provided to an employee on secondment when that employee continues to maintain a home in their original location. In this situation it is accepted practice for such expenditure to be treated as non-taxable to the employee. This treatment and its approval by the IRD dates back to the now expired (in 1998) Technical Rulings Manual, which included the following statement:

57.11.1.1 Exemption - Cases will arise where an employee is required to live away from his/her normal place of residence. He/she is required to maintain the normal place of residence for the family while working away from home. In these cases, there will be no benefit in respect of the accommodation supplied by the employer as the cost of maintaining the family home will offset any benefit received. The value of the accommodation supplied will not be taxed.

In contradiction to its own historical commentary, the IRD have now advised:

- Where an employer provides accommodation or an accommodation allowance, the amount is taxable and subject to PAYE,
- When accommodation payments have been made by the employer for expenditure incurred by the employee the amount is taxable and subject to PAYE,
- Accommodation for overnight and short-term stays by an employee in another location is not taxable.

The statement has been poorly received as the IRD's view is arguable, however due to the lack of technical analysis provided, it is difficult to confirm how the IRD has reached its view. The IRD have advised that taxpayers should make a voluntary disclosure if they have not treated amounts correctly. For this purpose the statement should be referred to as the period of reassessment, and application of interest and penalties will vary depending on the facts.

CHANGES TO HERD LIVESTOCK SCHEME

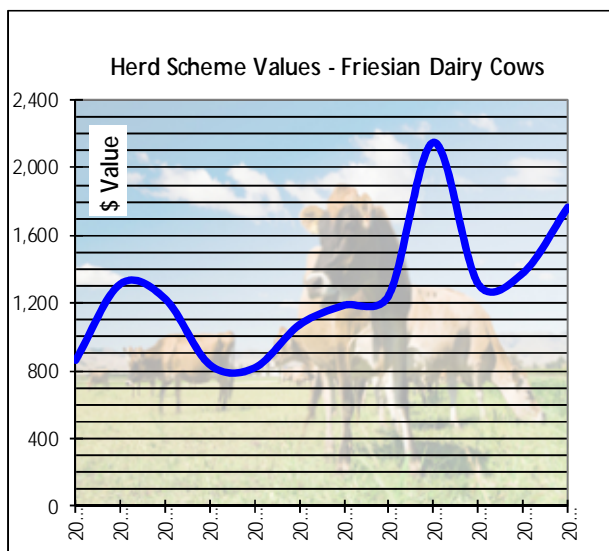
Change is here...

The Herd Livestock Scheme (officially called the National Average Market Value scheme) has been in existence since 1987. There were a few changes made in 1993 but essentially the scheme has remained largely unchanged over its lifetime.

On 18 August 2011 IRD released an official 'issues' paper which raised some concerns IRD had about how some taxpayers were using the herd scheme to their own advantage and - in the IRD's view - gaining an unfair tax advantage over other taxpayers.

Over the last few years in particular there have been some massive swings in the National Average values for some classes of stock. This is demonstrated in the graph adjacent for Friesian Mixed Age cows. These valuation swings were never anticipated when the herd scheme was introduced.

Late in March 2012 IRD announced that they were changing two areas of the Herd Livestock Scheme to address the concerns they had raised in their issues papers.



Move to irrevocable elections

From 18 August 2011 (the date the 'issues' paper was released) farmers will not be able to elect out of the herd scheme. In other words, once you are in the herd scheme you are there for the long haul (there are a couple of exceptions noted below).

Previously if you wanted to exit the herd scheme you had to give a two-year notice to IRD that you were doing so - as an example if you wanted to exit the herd scheme in 2012 you had to file the election to exit when your 2010 income tax return was filed. Because some taxpayers were able to delay the filing of their 2010 tax returns until March 2011 they were able to gauge exactly where livestock values were heading and therefore make a strategic decision about whether to remain in the herd scheme or exit it.

By exiting the herd scheme when values were at a high level the farmer was then able to obtain a tax deductible write down in stock values over a five year period.

Suggestions were made to IRD to simply extend the two year notice period to three years - making it harder to read what the market is doing in the future. IRD decided this was not ideal and have taken a much harder line.

What if I filed an election to exit after 18 August 2011?

Any elections to exit the herd scheme in future years that have been filed after this date will not be effective. IRD have said that farmers and their accountants became aware of the issues surrounding livestock valuations in the May 2011 budget and when the detailed issues paper was released. In order to maintain the tax base they are therefore backdating the application of this ruling.

What exceptions are there to these new rules?

There are now only two instances where you are able to exit the herd scheme:

1. When there is a change of farming operation to a fattening regime where a cost-based valuation regime would be more appropriate, and
2. Where there is a complete inter-generational change in ownership of the herd.

Associated party transactions

If a purchaser of a herd is associated with the seller of the herd, the purchaser will be required to adopt the vendor's herd scheme elections and base herd numbers. This move is designed to stop taxpayers

selling their herd from one entity to another (e.g. from a partnership to a company) and therefore essentially exiting from the herd scheme.

The definition for 'associated persons' for these purposes has yet to be released but it is suggested it should mean 'individuals within two degrees of association, spouses, family trusts and companies, whether owned by the trust or the family directly'.

What happens now?

IRD are still looking at a couple of other aspects of the herd scheme and there may be some more changes coming in the future - these will however be relatively minor compared to these major changes that have just been announced.

If you have any concerns about your herd scheme valuations or would like some further advice on this matter please do feel free to contact us to discuss.

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



If you are interested in finding out more about the products available from BankLink that can help your business or farm please contact us

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