

NEWSLETTER

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TAX UPDATE

The Government has announced a number of tax changes in the past few months, resulting in media releases and draft legislation being tabled in Parliament. The draft legislation includes:

- Rules to limit deductions for land, such as the Kiwi bach, and assets costing more than \$50,000 (e.g. yachts) that are used both personally and to derive income. The changes don't come as a surprise, as they were first signalled in the Budget and have gone through a public consultation process. Although one element of the draft legislation that was not expected, is that of 'ring-fencing' losses in certain circumstances, i.e. some losses incurred from a "mixed-use" asset will only be able to be offset against income derived from the asset in future years, as opposed to being offset against other income of the taxpayer.
- Proposed changes will allow non-resident businesses to register for GST and claim input tax deductions; subject to meeting certain registration criteria. In general, if a GST registered taxpayer incurs GST on the acquisition of a good or service to make taxable supplies in New Zealand, that taxpayer can deduct that GST in their GST return. In contrast, non-residents are currently often unable to recover New Zealand GST because they don't sell goods or services in New Zealand, which hurts New Zealand's international competitiveness.
- When depreciation loading was removed from assets acquired after 20 May 2010, the rules relating to the agricultural and horticultural industries were overlooked. To correct the oversight, the amortisation rates that apply to taxpayers in those industries will be reduced for assets acquired from 13 September 2012.

Building on an Officials' Issues Paper released in April 2012 regarding the tax treatment of salary trade-offs, the Revenue Minister announced on 3 October 2012 that the provision of car parks on an employer's premises will be subject to FBT (currently exempt). FBT would only apply to car parks located in the Auckland and Wellington CBDs. Exclusions will also apply for after-hours shift work and disabled car parks. The changes are to apply from 1 April 2014.

Another Officials' Issues Paper released in July this year proposed to charge tax on lease inducement payments (paid by landlords to entice potential tenants to enter into a lease). These payments are generally non-taxable to the tenant and deductible to the landlord. The proposal sparked heated debate because it was made without warning and was to be effective from the date it was announced. However, on 27 September 2012 the Minister announced the application date will be 1 April 2013 and the form of the proposal will be altered to capture all lease payments. This is in response to criticism that the proposal as originally intended, only captured some lease payments and was therefore one-sided - favouring the Government.

REMUNERATION OF SHAREHOLDER EMPLOYEES

The *Penny and Hooper* decision is a landmark tax avoidance case that has implications for small businesses operating through a company or trust. Essentially, the Supreme Court decided in favour of Inland Revenue, concluding that setting artificially low salaries amounted to tax avoidance.

Penny and Hooper were two orthopaedic surgeons, each earning taxable income of between \$600k and \$850k a year. They restructured their businesses into companies with a family trust owning most of the shares. They provided their services to the companies in return for salaries of \$100k - \$120k each year. The balance of the company's income was declared as dividends to the family trust which the surgeons drew from regularly.

Each year tax of between \$20k and \$30k was saved by having the profits after salaries taxed at the trustee rate rather than at the surgeons' individual top personal tax rates. The court found these savings a 'more than merely incidental' reason for their low salaries.

The IRD has put businesses on alert and is actively reviewing those operating through a company or trust where the income is generated from services provided by an individual, and the individual's salary is unreasonably low. Although there may be good reasons for setting the salary low in a particular year, e.g. adverse business conditions, or a planned expansion of the business, in some cases the sole reason for the salary level is to take advantage of the lower tax rate that applies to companies.

The IRD is entitled to go back four years into a business' records, but have publicly confirmed that where a 'voluntary disclosure' is made, only the last two income tax returns will be reassessed. A voluntary disclosure might significantly reduce IRD penalties or avoid them entirely.

Whenever we're discussing your business we'll look at this for you. In the meantime, if you are concerned and would like to discuss this with us, please do contact us.

STANDARD MILEAGE RATE INCREASES

The IRD standard mileage rate for motor vehicles is now 77 cents per km. This rate applies to the 2012 income year. The standard mileage rate may not be acceptable where an employee's business travel exceeds 5,000km. The reimbursement should be based on actual expenditure or a reasonable estimate of the expenditure likely to be incurred by the employee.

ACC & ACCIDENT INSURANCE

Protection against the consequences of personal injury is an important part of operating any business. The options that are available include ACC CoverPlus, ACC CoverPlus Extra, no cover or acquiring insurance from a private provider.

All self-employed and shareholder employees should have some form of ACC cover. If no action is taken ACC CoverPlus is the default policy that will apply.

ACC CoverPlus provides 24/7 cover for all workplace injuries, weekly compensation based on 80% of an individual's earnings and access to a full range of medical and rehabilitation benefits. However, in self-employed or shareholder employee situations, this policy may not provide a satisfactory level of compensation and the requirements to satisfy a claim can be onerous. For example, a person's prior year income tax return may not be sufficient to prove a person's loss of earnings.

ACC CoverPlus Extra can provide a better option. It has all the standard benefits of ACC Coverplus. However, you can negotiate the level of cover, so that 100% is received should an accident occur. There is also no requirement to prove loss of earnings when making a claim. The additional cost of the cover is approximately 4% more than the default cost.

For example, a self-employed tradesman injures an arm and his doctor issues him with a certificate stating a recovery period of six weeks.

- If the tradesman has ACC Coverplus, he would have to report to ACC to confirm the number of hours worked each week to determine his entitlement to compensation and prove his loss of earnings, which can be difficult if his income fluctuates from year to year.
- Compared to ACC Coverplus Extra, under which the tradesman has previously agreed cover for \$800 per week, ACC will pay this amount as weekly compensation with no adjustments and no requirement to confirm loss of income.

A shareholder-employee with no PAYE or shareholder salary allocation from the company would by default have no ACC cover, however they can apply for ACC Coverplus Extra.

Private Insurers offer additional options for accident and sickness cover through one of the commercial insurers. In some cases a combination of both ACC and private cover may provide the best solution.

Each individual should evaluate their own personal circumstances, risks and associated costs to determine the best option.

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Important: This is not advice. Clients should not act solely on the basis of the material contained in *The Client Newsletter*. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. *The Client Newsletter* is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.