NEWSLETTER

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Family Assistance Changes

What is generally referred to as family assistance has typically been a tool employed by the government to provide financial support to ensure low income families can comfortably meet their day to day living costs. These days it is being referred to as family assistance tax credits. Changes that came into effect on 1 April 2006, build on adjustments to the rates and thresholds made from 1 April 2005.

The debate over general tax cuts versus targeted tax credits continues. In the mean time the government's package is now in effect and some guidance is provided below to help determine if you may be entitled to "tax credits".

Rather than focusing on how entitlements are worked out, the focus is on the areas more relevant to people in business who may have income from various sources. As an indication of how high your income can be before a family will not be entitled to tax credits, a family with 3 children that is eligible for "family support" plus the "in work payment" can earn up to $93,760.00 and receive family assistance. This amount could be higher depending on the age of the children. For more information and other scenarios, please see the IRD website at www.ird.govt.nz.

A family's entitlement is based on its "net income" subject to certain adjustments. Net income is different to taxable income. Net income is basically your total income less any allowable deductions such as accounting expenses, but before losses from previous years are taken into account. Any losses received from a Loss Attributing Qualifying Company must also be ignored when calculating your income. Income is also adjusted for any child support or maintenance received or paid.

Changes that occurred in the 2004 year mean that items like income equalisation deposits, income spreads, building depreciation and development expenditure no longer need to be adjusted.

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Sole traders must include their profit in the calculation but if their business makes a loss it is ignored. If a person runs two businesses that are normally carried on in association with each other, they may be deemed to be one business. This allows the loss of one to be offset against the profit of another. Keep in mind if someone makes a rental loss it would be taken into account unless they are in the business of renting.

Depending on the level of shareholding, shareholders in some companies may need to include as income a share of profit based on their proportion of shares held, less the amount of any dividends received from the company.

New Legislation

The long awaited Tax Bill that was resurrected after the 2005 election, is now law. This Bill has received considerable attention as it introduces a large number of changes. As the Bill made its way through the parliamentary process, some changes were made to the draft Bill. Some of the amendments that were made to the Bill and the practical effect of those amendments, are identified below. The effects of other amendments made to the Bill, will be discussed in coming issues.

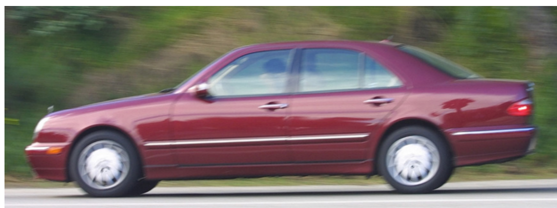
Provisional Tax

As the Bill was passed so close to the start of the 2006 tax year the changes to provisional tax have been deferred for one year. Further information will be provided on the changes to provisional tax, closer to implementation date.

Vehicle Benefits

One of the changes having a widespread effect is in relation to vehicles leased under a “nine to five” or “flip lease”. These vehicles are now subject to FBT when private use occurs during the lease period. Options available moving forward include:

1. leaving the lease in place and paying FBT,
2. selling the vehicle to the company and paying FBT, or
3. cancelling the lease and reimbursing the business running using the mileage rates or a reimbursement based on actual costs.



The best option will depend on individual circumstances. You may need professional advice on the best option for you. In the meantime, a couple of facts that may be of assistance are noted below.

In an earlier newsletter, we advised the value of the vehicle benefit over a five year period under the book value method versus the cost method is equal. One of the changes to the Bill has seen the depreciation rate for vehicles increase to 36% DV (including 20% loading) compared to the current rate of 31.2% DV (including 20% loading). This means that over a five year period the book value method is cheaper than the cost method. This saving only occurs in the fifth year, so if a vehicle is likely to be held for a shorter period than 5 years, the cost method is still the winner.

For the cost method, if the vehicle has been purchased from an associated person the value of the benefit will be based on the associated person’s cost price. This rule does not apply if the book value method is used. The vehicle benefit would be calculated on the market value of the vehicle at the time of transfer from the associated person.

Low Interest Loans

In an earlier version of the Bill there was the option to use a market interest rate instead of the prescribed FBT rate, when calculating the value of the benefit of a low interest loan to an employee. Unfortunately, this has not eventuated in the Act and the option of using market interest rates is now only available to lending institutions. However, in what is seen as a positive change from the original version, as of 1 April 2006 loans valued at less than $2,000 per employee at the end of an FBT return period will be exempt from FBT.

Shortfall Penalties

A positive addition to the Bill was made in its final stages relating to the penalty charged by the IRD for taking an unacceptable tax position. The stance the IRD took in the past was very “black and white” and this was often seen as unfair and a disincentive to voluntary compliance. For example, if a mistake was made in a return that was identified and disclosed to the IRD a shortfall penalty for unacceptable tax position could still apply.

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The changes under the Bill mean a taxpayer will not be liable for a penalty if:

1. the Commissioner is satisfied the tax position taken was as a result of a clear mistake or simple oversight; and
2. the shortfall is eligible for a voluntary or temporary reduction, and
3. it is appropriate that the taxpayer not be liable for the penalty.

How the subjective requirements will be interpreted by the IRD remains to be seen, however it is definitely a step in the right direction.

These changes recognise that penalties may have been imposed that are contrary to the IRD's aim of fostering voluntary compliance. Therefore, the new provisions allow penalties on tax positions taken after 1 April 2003 to be refunded if they meet the requirements above. In order to have a penalty remitted a request must be made in writing before 1 October 2006.

New Holiday Pay Rules

The Government has decreed that all employees shall be entitled to a minimum of 4 weeks annual leave from 1 April 2007. At face value, this is all very simple - unless you are the unfortunate soul who administers the payroll. There are fishhooks galore for the unwary.

The Holidays Act states that *'on and from 1 April 2007, when the employee next becomes entitled to annual holidays, the employee's minimum entitlement is increased from 3 weeks' annual holidays to 4 weeks' annual holidays.'*

This means that on the anniversary date *preceeding* 1 April 2007, the employer needs to start accruing for the 4 week entitlement. If your anniversary date is 2 April, then the 4 weeks leave starts accruing on 2 April 2006 and the entitlement falls due on 2 April 2007.

But, if your anniversary date is 30 March, the 4 weeks leave starts accruing on 30 March 2007, and the entitlement falls due on 30 March 2008, being the date *the employee next becomes entitled* after 1 April 2007.

If an employee has an anniversary date of 2 April, and they have been accruing leave at 4 weeks, but resigns on 15 March 2007 (ie before the entitlement comes into force in law), they are only entitled to the equivalent of 3 weeks holiday pay entitlement, not the full 4 weeks that has been accrued.

In this situation there is a huge trap of expectation, if the employee has been watching the holiday pay accrual grow on their pay slip. To deal with this, some payrolls have developed a shadow accrual facility, so the accounting system can keep track of the 4 weeks accrual but the pay slip shows the 3 week accrual, until the entitlement is earned.

The other trap with the accrual showing on pay slips is that staff may want to take the leave before they are entitled.

For staff who already have an entitlement of 4 weeks there is speculation about entitlement to 5 weeks. Where the agreement states 4 weeks, this remains the case, unless the employer elects to be generous. Where the agreement states one week in addition to the minimum entitlement, the employees will be entitled to 5 weeks.

If you have some staff on 4 weeks and others on 5 weeks, you will need to review the relativities and make sure that it is fair.

The last thing you want to do is upset your staff for the sake of 1 week's leave.

Relationship Property – Yours or Mine?

Things can get messy when a couple parts company. A case recently decided in the Wellington District Court highlights the fact your property may be at risk during a relationship breakup and someone might try to take that property - but they won't necessarily succeed. Mr M and Ms L were in a de facto relationship from March 2000 until some time in February or March 2002. This was classified as a relationship of "short duration", as it was for less than 3 years.

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Mr M had applied for an order for division of property under the Property (Relationships) Act 1976 (PRA). Before an order could be made there had to be a child of the de facto relationship or a substantial contribution by Mr M and serious injustice if an order was not made.

Both parties had been married before and both had children but there was no child of the relationship.

Ms L had acquired substantial property in her own name at the start of and during the relationship. They lived on one of the properties for a few weeks until they separated. Mr M did not contribute financially to any of the properties except to help repair one of them.

At the start of the relationship Mr M had a Toyota Surf vehicle with very little equity, his tools of trade, and a debt of about $12,000 to the Inland Revenue Department. If he had cashed up he would have had a shortfall.

In analysing a partner's contribution to the relationship the courts considered the quality and quantity of any contribution, financial or material, effort made, particular or special skills, abilities or qualifications, personal attributes, results achieved, any long-term or potential benefits to the other partner.

After reviewing all the facts the Court considered that Mr M had not made a substantial contribution and their respective positions at the end of the relationship did not result in a serious injustice. Therefore no order for division of property was made.

Financial Reporting Changes for Small Companies

Small companies are given a number of concessions for financial reporting purposes if they meet certain criteria. They are classified as "exempt companies".

At present the criteria are turnover of less than $1 million and total assets of less than $450,000. The Commerce and Small Business Minister recently announced some proposed changes to the financial reporting system which are aimed at reducing compliance costs for small companies. The changes expected to be introduced will extend the criteria to exempt companies that meet two of the following three criteria:

- less than $2 million turnover,
- assets of less than $1 million,
- 5 or fewer full time equivalent employees.

The change will effectively mean that the process of reporting for a large number of companies will become a lot simpler and reduce compliance costs.

Overseas Companies

Another change that is expected will mean that if a company with 25% or more of overseas ownership qualifies to prepare its financial statements under the differential reporting framework or the small company exemptions outlined above, it will no longer have to file audited financial statements with the Registrar of Companies. To qualify under the differential reporting framework, the company must satisfy at least two out of the three following tests:

- annual turnover of less than $20 million,
- assets of less than $10 million and/or
- 50 or fewer full time equivalent employees.

Little Snippets

Old Depreciation Determinations Under The New Act

The IRD has stated that depreciation determinations issued under the 1994 Income Tax Act will continue to apply as though they were issued under the 2004 Income Tax Act.

The new Act includes a provision which basically allows other documents that refer to the 1994 Act to be read as though they refer to the 2004 Act.

Immigrants Foreign Income Exemption

From 1 April 2006 foreign sourced income earned by some immigrants will be exempt from tax in New Zealand for four years. The exemption is available if they have not been tax resident in New Zealand for at least ten years. It is hoped the exemption will attract immigrants to New Zealand.

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

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