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## Developments On The Employment Front

### Amendments to Employment Agreements

All existing employment agreements (including written and unwritten (oral) employment agreements) must be amended by 1 December 2005 to include an "Employee Protection Provision". The purpose of the provision is to provide protection to employees who might be affected by their employer's business restructuring. The Employee Protection Provision must set out the process the employer must follow where there are affected employees whose employment may transfer to the new employer after the employer's business is restructured.

The Holidays Act 2003 stipulates that all existing employment agreements must be amended to include a provision that confirms employees' rights to be paid "time and a half" for working on a public holiday.

### Minimum Wages

The minimum wage was revised upwards with effect from 21 March 2005. The new wage rates are:

|                    | <b>Youths (16 &amp; 17 year olds)</b> | <b>Adults (18+ years)</b>  |
|--------------------|---------------------------------------|----------------------------|
| Per hour           | \$7.60<br>(was \$7.20)                | \$9.50<br>(was \$9.00)     |
| 8 hr working day   | \$60.80<br>(was \$57.60)              | \$76.00<br>(was \$72.00)   |
| 40 hr working week | \$304.00<br>(was \$288.00)            | \$380.00<br>(was \$360.00) |

### Parental Leave

The Parental Leave and Employment Protection Act 1987 was amended from 1 December 2004 to amend the entitlements to parental leave and employment protection.

Employees who have been employed by the same employer for at least an average of ten hours a week during the immediately preceding six months, are now entitled to 13 weeks' maternity leave or one week's partner's / paternity leave.

This entitlement to maternity leave will increase to 14 weeks after 1 December 2005.

Certain medical practitioners and teachers who have periods of employment with more than

one District Health Board or Board of Trustees respectively, may be treated as having one single employer.

## **New Direction For Charities**

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The Charities Act was passed on 13 April 2005. It creates a Charities Commission, which will be involved in the administration of charities. The Commission's role will commence from 1 July 2005. The aim of the Commission is to:

- promote public trust in charitable organisations;
- encourage best practice in governance and resource use by charitable organisations;
- provide advice to government on matters relating to charities; and
- promote or undertake research into matters relating to charities

### **How The Act Will Affect The Charitable Sector**

- The Charities Commission will be an autonomous Crown entity. The Department of Internal Affairs will be responsible for monitoring the Charities Commission.
- Its role will be two-fold. Firstly, to provide an education and support role to the charitable sector. Secondly, to register and monitor charitable entities that wish to keep or obtain income tax exempt status.

### **Registration**

Registration will be voluntary, but a charity will need to register with the Commission to continue to be exempt from tax. The register of charities will not come into existence until March 2006 at the earliest, and there will be a reasonable transition period after that, before registration will be necessary to retain or obtain income tax exemption.

A registration number will be issued. There is no requirement to display the number on all materials but organisations may do so if they wish. However, organisations will be required to disclose this number at a member of the public's request, if they are invited to make a donation over the phone or internet. This requirement is an important safeguard and will

be useful in providing the public with a high degree of confidence that an organisation is undertaking activities that are both charitable and in the public interest.

A charity that chooses not to register with the Commission would still be able to call itself a charity and solicit funds from the public. It would, however, not qualify for tax exempt status.

### **Compliance**

Registered charities will be required to:

- Submit an annual return that will outline their charitable purpose and activities and provide basic financial data such as the organisation's income, outgoings and net worth.
- Notify the Commission if certain core information, such as the organisation's charitable purpose, has changed during the year. This is to ensure that all information held on the register is as up to date as possible. Penalties will be imposed for failure to notify within a specified time.
- Assist the Commission with any investigations that it undertakes in performing its statutory monitoring obligations. It will be an offence for any charitable organisation to fail, without reasonable excuse, to supply the Commission with information and documents that have been requested during an investigation.

The information provided in both the registration and annual return processes will be publicly available from the Commission's register.

The Charities Act is intended to ensure that charities become more accountable and transparent to the public, funders and government – but the cost of the accountability and transparency will be seen in the extra administrative requirements, and must be borne out of the funds which would otherwise benefit the charities' beneficiaries.

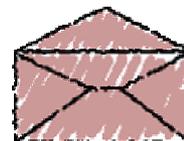
## Disputes Resolution Update

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The Disputes Resolution process has had an overhaul and changes to the process came into effect from 1 April 2005:

- The allowance for a time bar waiver has been extended from the current period of 6 months to 12 months, with a further option of a 6 month extension being available to the taxpayer. New issues cannot be raised during the time bar period.
- Where a Notice of Proposed Adjustment (NOPA) has been issued and the matter has not been agreed to, the Commissioner must complete the disputes process and not make an amendment under Section 113. A number of exceptions exist; however, in most cases these exceptions will not apply.
- A taxpayer and the Commissioner may agree to suspend a dispute where a “test case” is identified and where the facts and relevant law are significantly similar. The Commissioner may make an assessment or perform an action that is consistent with the outcome of the “test case”.
- Taxpayers now have four months to issue an NOPA to the Commissioner to dispute an assessment. It was previously two months.

- The contents required for an NOPA have been altered with the intention of making them streamlined. Taxpayers are also required to provide documentation to support an NOPA.
- The amount in dispute in order to take a case to the Taxation Review Authority has been raised to \$30,000. It was previously \$15,000.
- The Commissioner’s discretion to accept a late NOPA or NOR, (Notice Of Response) has been widened to include minimal delay and delays related to public holidays. For example, if a response period were to end on Good Friday, but an NOPA was posted on Thursday and was not received by the Department till the following Tuesday, the Commissioner may accept the notice as being received in time.
- The time bar for GST disputes has also been clarified. It is the 4-year period from the end of the GST return period in which the GST return was provided.



As to whether or not these changes will make any noticeable difference to the taxpayer – only time will tell.

## Interest Deductibility

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In general, people have the correct understanding that interest is deductible if it is incurred directly in relation to acquiring assets that are used to derive income. However, some confusion exists when it comes to interest incurred for reasons that are not directly related to earning income. For example, when someone borrows to pay taxes or if a qualifying company borrows to pay a dividend. In order to try and provide some clarity on the issue the IRD recently issued a draft interpretation statement on interest deductibility.

Deductibility will depend on the use made of the funds borrowed. So, interest is deductible if it is incurred in deriving assessable income or incurred in carrying on a business for the purpose of deriving assessable income. It is not deductible if the funds are used for a private or domestic purpose.

What about interest on funds borrowed to acquire capital assets? The *Pacific Rendezvous* case confirmed that interest is deductible on funds borrowed to acquire capital assets that are used to produce income. Since this case, the courts have applied a “use” test, to identify what the funds were used for and therefore determine interest deductibility. For example, if a person took out a loan to purchase a property to generate rental income, the interest will be deductible. However if the same person used the loan to purchase a new home to live in and kept their existing property to be used as a rental the interest would not be deductible. In the second scenario, the funds borrowed are being used to acquire a property that is not being used to derive income, therefore the interest is non-deductible. Although through the use of an appropriate structure, it may be possible for the interest to be deductible.

The “use” test is relatively easy to apply. In the *Public Trustee* case the issue related to funds borrowed to retain income earning assets. Money was borrowed to pay death duties so that income earning assets did not have to be sold to pay the duties. In this case, the necessary connection was not so easy to identify. In the example where a taxpayer borrows to pay a tax bill, you still need to look for a connection to the income earning process.

The analysis could be as follows:

- A tax bill is a mandatory liability placed on a taxpayer.
- If the taxpayer does not borrow to pay the taxes, he may have to sell income earning assets to fund the tax bill. Therefore to

safeguard his ongoing income earning process the borrowing has to occur.

- In addition, if the tax bill itself came from the use of those assets, it can be shown that the borrowings are being used to maintain the income earning assets and therefore, the link to the income earning process is established.

With a qualifying company that borrows funds to pay a dividend, the interest would not be deductible as it has not been incurred to derive income and is not in relation to acquiring or retaining income earning assets.

As the circumstances in every case can vary, we recommended that the “use” test be applied before including interest deductions in your tax return.

## Little Snippets

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### Rates and Thresholds

A number of changes have been made to rates and thresholds, as follows:

1. Use of Money Interest charged by the IRD has increased from 11.93% to 13.08%, the interest rate paid by the IRD has increased from 4.83% to 5.71%, and the new rates will apply from 8 March 2005. Where the tax payable is significant, tax pooling should be considered to save use of money interest.
2. The changes effective from the 1<sup>st</sup> of April 2005, are as follows:
  - Student loan threshold has risen from \$16,172 to \$16,588
  - The student loan interest rate has remained unchanged at 7%, although the base interest portion has decreased from 5.5% to 4.2%, accordingly the interest adjustment portion has increased from 1.5% to 2.8%
  - The maximum income level for a full interest write-off for part-time or part-year students has risen from \$26,140 to \$26,799
  - ACC earners levy rate has been set at \$1.0667 per \$100 of earnings, exclusive of GST ie \$1.20 per \$100 of earnings (GST inclusive)
  - The maximum amount on which a self-employed person can be levied for ACC purposes has increased from \$88,728 to \$92,189. The maximum amount for any other person has increased from \$92,189 to \$94,226

- The level of earnings on which a levy is payable for a self employed person working more than 30 hours per week has increased to \$17,680 and \$14,144 for those aged 17 or under
- The FBT rate for low interest loans has risen from 8.52% to 8.76%

### Income Equalisation

A timely reminder to farmers that the income equalisation scheme is an option to consider especially when there has not been sufficient provisional tax paid on income earned. A deposit into the income equalisation scheme will defer the income tax liability to a future year, enabling farmers to “square up” their tax payments accordingly. The scheme is especially useful when there are unexpected income fluctuations. Operating like a bank account, the scheme allows farmers to make payments for a rainy day.

### “Market” Salary

Trading trusts are coming under increasing scrutiny from the IRD if the trusts employ professionals to provide the services of their business. IRD has been targeting trading trusts that have been paying salaries to associated persons at what the department considers to be less than market salary, for what it considers to be the provision of personal services. In a recent media release, the Department indicated that the requirement to pay “market” salaries may not be restricted to trading trusts. IRD has indicated that companies may receive similar scrutiny if it believes “market” salaries have not been paid.

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