



NEWSLETTER

Issue 4
November 2010 – January 2011

Inside this edition



More GST Changes Ahead	1
Providing Credit and Managing your Debtors	2
What is Employment Disputes Insurance?	3
Changes to the QC / LAQC Regime	3
Snippets	4
<i>Provisional Tax</i>	4
<i>IRD Work Programme</i>	4

More GST Changes Ahead

Recently the focus has been squarely on GST due to the increase from 12.5% to 15%. That focus is set to continue with the release in August 2010 of draft legislation to amend the GST Act with effect from 1 April 2011.

Change-in-use adjustments

A central principle of the current GST Act is the need for a good or service to be principally acquired for the purpose of making taxable supplies (e.g. sales) before GST can be



wholly claimed up-front. If a good or service is not acquired for a wholly taxable purpose a change-of-use adjustment may be required. Depending on the situation, the change-of-use provisions can be complicated and expensive to administer.

It is proposed that the change-of-use provisions are re-written and the principal purpose test is repealed and replaced with a “use” doctrine such that when an asset is acquired for a mixed purpose, a one-off input tax deduction will be made based on its estimated use. This deduction is subject to adjustment at a later date if the actual use varies from the estimate.

Zero-rating of land transactions

Schemes designed to acquire GST refunds from IRD on the purchase of land where the vendor is unable to meet its GST output liability, have caused the Government to propose zero-rating transactions that include land. Zero-rating will apply to the taxable sale of land by a GST registered vendor to a GST registered purchaser who intends to use the land for the purpose of making taxable supplies. Where land is only a component of a transaction, i.e. the sale of land and buildings, the entire transaction will be zero-rated.

All information in this newsletter is to the best of the authors' knowledge true and accurate. No liability is assumed by the authors, or publishers, for any losses suffered by any person relying directly or indirectly upon this newsletter. It is recommended that clients should consult a senior representative of the firm before acting upon this information.

As the purchaser's use of the land will determine whether zero-rating will apply, a vendor will be required to confirm the purchaser's intentions, and that they are GST registered. If the vendor fails to meet its obligations to gather the required information, it may be liable to pay the applicable GST. If the vendor is unable to gather the required information because of the actions of the purchaser, the purchaser may be held liable for that GST. If an unregistered purchaser provides false information to avoid paying GST and that is subsequently found out, the purchaser will be deemed to be registered and will be required to pay the applicable GST.

To clarify the boundaries as to what transactions will be zero-rated, a definition of "land" will be inserted into the proposed legislation. As currently drafted, the definition includes an option to acquire land, an estate or interest in land, and rights that give rise to an interest in land. Based on the definition as drafted the commercial leasing of land will be zero-rated. However, it is understood this application to commercial leases is currently being re-considered by Government and is unlikely to be included in the final form of the legislation.

Taking the zero-rating of land and the change-of-use adjustment changes together, if a registered person buys land for a mixed use, the transaction will qualify

Providing Credit and Managing your Debtors

Cash flow management is fundamental for helping build and maintain a successful business and debtor management plays a key role. It may be beneficial for some businesses to supply goods and services without immediate cash payment by offering credit.

Credit can provide customers with the ability to purchase more expensive items than they would otherwise be able to purchase with cash. It provides flexibility in financing options and can demonstrate a level of trust between the customer and the business. Further, it suggests the business is in a healthy cash position as it can offer credit. This may be an important indicator for trade customers seeking security through reliable suppliers.



Key points for debtor management include:

- deciding who will be offered credit,
- how much credit will be offered, and
- drafting the documentation for enforcement of credit terms.

for zero-rating, however, the purchaser will be required to pay GST based on its estimated non-taxable use.

"Dwelling" definition clarified

The distinction between what is a "commercial dwelling" versus a "dwelling" is important for GST purposes as the supply of accommodation in the former is subject to GST, but supplying accommodation in the latter is not. The current definitions have been the source of uncertainty in the past as activities such as homestays, farmstays and serviced apartments have not fit neatly into either definition. In 2006 the IRD issued a draft interpretation statement that broadly concluded these types of activities would not qualify as the supply of accommodation in a commercial dwelling and therefore are not subject to GST.



The proposed changes will expand the commercial dwelling definition to specifically include homestays, farmstays and serviced apartments. Furthermore, the proposed changes will clarify the law by requiring a dwelling to be a person's principal place of residence and be subject to their exclusive possession.

Before you agree to perform any work for a client or supply goods to a customer, ensure you have policies in place to protect your cash flows. A well-drafted and succinct set of credit terms that are signed, dated and understood by your debtors is invaluable. Before goods or services are supplied, communicate the terms clearly to customers, ensure the terms are signed and dated by both parties and that each have a copy for their records.

Before accepting a customer as a substantial debtor, carry out a credit check and ask for two referrals. Credit checks can provide useful information regarding the person's credit application and payment history, including whether any debts have been referred to debt collection agents. A blank record may show no signs of non-payment but may also mean the person has not chosen, or been able, to apply for credit in the past 7 years. In this situation, the referrals may provide valuable information on the customer's payment history.

Most first-time creditors should have a low credit limit until a pattern of repayment is established. All credit limits should be enforced through systems that are able to detect the first breach and effect an immediate, albeit temporary, stop to the line of credit. All non-payments should be promptly pursued and always in a

friendly manner. There may be a rational explanation for non-payment, but remember, every dollar matters!

Credit terms should be clear, concise and robust. At a bare minimum, they should contain the following:

- The clients contact details: including full names, street and postal addresses, phone and email details,
- A customer authority for signing, and whether the signatory has the appropriate authority, should be confirmed. Preferably, a company's directors should sign the credit terms and personally guarantee the company's debts,

- A description of what is to be supplied,
- A retention of title clause (ensure the security interest is registered on the Personal Property Securities Register),
- Details of how the fees/charges will be calculated and details of the credit terms,
- Who is liable for the work performed, limitations of that liability and who is liable for legal costs and debt enforcement, and
- Procedures for mediation and arbitration to resolve disputes.

What is Employment Disputes Insurance?

With the level of media coverage of seemingly irrational and sometimes expensive personal grievance cases, most employers have a fear of personal grievances being taken against them. When the Employment Relations Act was introduced in 2000, there was a significant growth in organisations taking out Employment Disputes Insurance but it rarely gets mentioned these days.



As with most insurance policies, it is important to advise the insurer at the first sign of trouble (before the employee is dismissed) and follow their instructions carefully. The insurer will normally direct the employer to use an employment law advisor of the insurer's choosing, or will want to approve your adviser.

So what is Employment Disputes Insurance and how does it work? As with all insurance products, it varies according to the different providers; so this is a general explanation rather than a detailed summary of all products.

Employment Disputes Insurance is designed to give employers the peace of mind that they will have some support in the event that a personal grievance is taken against them by an employee. The vast majority of grievances relate to claims for unjustified dismissal or unjustified action by the employer, causing disadvantage to the employee.

The insurance generally covers the legal costs of defending a grievance and any compensation, fines and penalties. The insurance does not always cover the wages settlement that the Employment Authority might order the employer to pay, or the legal costs up to the point of dismissal, but will generally cover the legal costs of going to mediation.

You should be aware that if a grievance is lodged, the insurer will generally want to minimise the cost of the claim and will call the shots on how the matter is to be resolved. This is not always a comfortable position for the employer, especially as the legal fees often exceed the cost of any settlement, so the employer might end up feeling forced into a settlement by the insurer so that the legal fees are contained.

Employment Disputes Insurance can be useful in some circumstances, but only if the employer has signalled the claim early enough and has followed the advice from their legal advisors every step of the way. For most employers personal grievances are very unpleasant emotional experiences that can be expensive, but generally do not break the bank. Given the recent changes in employment law, which can be challenging for even the most careful employers, whether insurance cover is appropriate will depend on how much peace of mind the employer wants and their specific circumstances.

Changes to the QC / LAQC Regime

In the 2010 Budget the Government announced that changes will be made to the qualifying company ('QC') and loss attributing qualifying company ('LAQC') regimes. The draft legislation outlining these changes has been released, which effectively proposes to eliminate LAQC's, while retaining QC's, and introduces a new vehicle called a look-through company ('LTC').

Similar to a partnership, the shareholders in an LTC are treated as personally deriving the income, incurring the expenses and owning the underlying assets and liabilities of the LTC. When a shareholder disposes of shares in an LTC it is deemed to be a disposal of the underlying assets. For example, if a shareholder in an LTC disposes of shares in an LTC that holds

depreciated assets, the shareholder may derive depreciation recovery income.

The look-through aspect applies for income tax purposes only - the company still retains its capacity as a separate legal entity for company law purposes, including limited liability status.



One of the benefits of the QC regime is the ability to distribute capital gains tax-free. By comparison an ordinary company can only distribute capital gains tax-free by liquidating the company. An LTC will provide this same benefit because dividends paid by an LTC will be ignored for tax purposes, as the income is taxed directly in the shareholder's hands when initially derived.

To cater for situations in an LTC where the profits are generated through the disproportionate efforts of its shareholders, that extra effort can be recognised by a pre-tax payment to a "working owner", i.e. a salary or wage. A working owner is a shareholder who is employed by the LTC under a written contract, and who personally and actively performs the duties of their employment under that contract.

Snippets

Provisional Tax

Due to the reduction in the company tax rate from 30% to 28%, the standard provisional tax uplift rates have been amended. The reduction applies to the calculation of a company's provisional tax liability for the 2011-12 and 2012-13 income years.

Provisional tax year	Based on year's RIT (Residual Income Tax)	Uplift rate
2012	2010	RIT + 5%
	2011	RIT (no adjustments)
2013	2011	RIT + 5%
	2012	RIT + 5%
2014 and onwards	2 years previous	RIT + 10%
	previous year	RIT + 5%

IRD Work Programme

Apart from acting as an agent of the crown in the collection of tax revenue, one of the IRD's functions is to provide guidance and assistance in the interpretation of tax legislation. This is in the form of publications such as Tax Information Bulletins, Interpretation Statements and Standard Practice Statements. The IRD also discloses projects it has on its radar through publication of the Public Rulings Work Programme.

Similar to the existing QC regime, in order to be eligible to be an LTC a company must be a New Zealand tax resident and have 5 or fewer "look-through counted owners". Broadly, the definition of look-through owners includes both individuals and trusts, with individuals who are related to the second-degree of blood relationship being counted as a single owner, as are trustees in a trust.

Existing QC's and LAQC's may transition into the LTC regime by making an election within 6 months of the start of the income year commencing on or after 1 April 2011. If a QC or LAQC does not elect to enter into the new regime, a QC will continue unchanged, while an LAQC will effectively become a QC, i.e. losses will not be able to be attributed to shareholders. When exiting the LTC regime, shareholders are deemed to have sold and re-purchased the underlying assets of the company at market value. The deemed sale could result in a tax cost, such as depreciation recovery.

This change is a chance for shareholders in existing QC's and LAQC's to review their current structure, and look at what would work best for them. Electing the LTC regime is not the only option - a partnership, limited partnership, sole trader or regular company structure may be a better fit.



The Public Rulings Work Programme is prepared by the IRD Public Rulings Unit which outlines priority work for the IRD.

The current programme includes items such as whether farmers are required to apportion mortgage interest between farm land and a residence located on the land. Ideally, for farmers, this will not result in a change to the long standing concession whereby farmers are able to claim 100% of their mortgage interest and 25% of the expenses relating to their home.



Further items include the income tax and GST implications of barter transactions and the income tax and FBT implications arising from trade bonus/reward schemes.

The Public Rulings Work Programme can be found at <http://www.ird.govt.nz/public-consultation/work-prog/>.

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