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Please take time to read our latest Newsletter and call us about any issues you may wish to discuss.

NEWSLETTER

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Inside this edition

KiwiSaver Changes 1
Labour's Capital Gains Tax 2
Compulsory Zero-Rating 3
Change in Confidentiality Case Law 3
Some Statistics Surrounding New Zealand's Tax System 4
Snippets 5
Rental Homes for the Rugby World Cup – IRD Focus 5
LTC Elections 5

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KiwiSaver Changes

Following the KiwiSaver changes announced by the Government in the 2011 Budget, legislation was enacted on 24 May 2011 to implement the amendments, which are being phased in over the next two years. The changes are intended to reduce the Government's costs to fund the scheme. Employers need to be aware of the changes to correctly administer their employees' contributions and meet their own obligations under the scheme.

The changes are to come into effect as follows:

- From 1 July 2011 the member tax credit will reduce by half to 50 cents per $1 dollar contributed, up to a maximum of $521 per annum. The maximum was previously $20 per week ($1,040 per annum). The $1,000 kick-start payment available to members when they sign up to KiwiSaver remains unchanged.
- Prior to the introduction of KiwiSaver, contributions made by an employer to an employee's superannuation scheme were subject to withholding tax in the form of Employer's Superannuation Contribution Tax (ESCT). With the introduction of KiwiSaver, an exemption from ESCT applied to the employer's minimum required contribution. From 1 April 2012 that exemption will be removed and the total employer contribution will be subject to ESCT. This change represents an increase in Government tax revenue and a decrease in the amount a member receives from their employer.
- The method for calculating ESCT has also changed. Before 1 April 2012 an employer could calculate ESCT at a flat rate of 33 cents in the dollar. After this date ESCT must be calculated at a progressive rate based on either:
    - where the employee has been employed for the whole of the previous year – the employee's

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annual salary or wages plus the gross employer contributions paid in the previous tax year, or

- where the employee was not employed for the total previous tax year - an estimate of the employee's gross salary or wages plus an estimate of employer's gross contributions for the current year.

Although not legislated at this stage, the Government has also signalled its intention to change the minimum contribution rate for employers and employees from 1 April 2013. These are currently set at a minimum of 2% for both employee and employer contributions. Both are expected to increase to a minimum of 3%. Members will still have the option to select a higher rate of 4% or 8% if they wish. This change is expected to apply to both existing and new members.

Employers will need to update their wages processes, as the changes come into effect, to ensure that KiwiSaver obligations are accounted for correctly.

Labour's Capital Gains Tax

Labour has commenced releasing its tax policy in the lead up to the November election, starting with the announcement to introduce a capital gains tax (CGT) if elected. The proposed tax will add another tax rate to New Zealand's tax system and that, combined with its intention to re-introduce a top personal marginal tax rate of 39%, provides taxpayers with plenty of motivation to structure their affairs to minimise their tax liability. Tax structuring, such as the sheltering of income in trusts, is another practice Labour intends to crack down on.

Labour has acknowledged that a team of experts would need to be set up to iron out the finer points of CGT. Labour has also confirmed that CGT will apply at a flat rate of 15% (not indexed for inflation) and will be applied to net gains on the sale of land and buildings, shares, rights and options, leases, goodwill, licences, convertible notes, contractual rights, foreign currency, minerals and precious metals, livestock (if on capital account), intellectual property rights and endowment policies.

There will be various exemptions available to taxpayers in the CGT regime including:

- the family home ("where you live most of the time") including a family home that is owned by a trust and the primary dwelling and curtilage on a farm,
- personal use assets such as boats, furniture, electrical goods and household items,
- collectables such as jewellery, artwork and stamp collections,
- pay-outs and withdrawals from retirement savings schemes,
- winnings and losses from gambling,
- small business assets up to $250,000, sold for retirement, where the owner is above, say 55, and has owned and worked in the business for more than 15 years, and
- property in the greater Christchurch area will not be liable for CGT for five years following the implementation of the tax.

The 15% CGT will only apply to increases in the value of an asset after the date the tax is implemented. This will involve a 'valuation day' or 'v-day' where assets will be valued at their current market value. This would be of some relief to those, such as farmers, who have owned their land for over 50 years and the value has increased exponentially since it was purchased.

If a CGT asset is sold and a loss is incurred, that loss can only be offset against CGT income, it can't be offset against other income such as salary and wages. If no CGT income exists, the loss will be carried forward until such time as CGT income is derived.

In order to prevent taxpayers avoiding CGT by giving away their assets, the tax will apply to gifts, with the liability falling on the person making the gift.

Roll-over provisions will enable transfers of assets by way of inheritance, or in the event of a relationship separation, to be transferred without being subject to CGT.

Labour has stated it intends to use the proceeds from CGT to pay down national debt, reduce individual taxes through a tax free threshold and remove GST on fresh fruit and vegetables. The tax is also intended to incentivise people to invest in other sectors other than housing and that house prices will become more affordable due to the reduced demand. On the one hand this may be true, on the other hand it could force rents up, making it harder for people to save for a deposit for their first home.

The outcome will be determined by whether voters believe income should be taxed once on derivation or whether the increase in the value of a person's assets, which are purchased from that income, should also be taxed. If introduced, CGT would represent a fundamental transformation of New Zealand's tax regime.

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Compulsory Zero-Rating

The compulsory zero-rating (CZR) of land transactions has been in force since 1 April 2011. Over the past few months, a number of common questions have arisen regarding the application of the new rules.

To summarise, the new rules require a transaction that wholly or partly consists of land to be zero-rated if:

- The vendor and purchaser are both GST registered, and
- The purchaser intends to use the land for the purpose of making taxable supplies, and
- The purchaser or a person associated with the purchaser does not intend to use the land as a principal place of residence.

The vendor is to rely on a written statement of intention from the purchaser to determine whether or not a supply of land should be zero-rated. The Auckland District Law Society (ADLS) and the Real Estate Institute have amended the standard form ADLS agreement to include an addendum and additional schedule to accommodate CZR.

There has been some confusion about how parties to an agreement are to complete the addendum, or in some cases not complete it. If a transaction is a basic sale of a residential house between two private parties (not GST registered) the sale is not subject to GST. Consequently, CZR can't apply and the addendum and schedules are 'not applicable'. However, some situations are not so straight forward.

As outlined above, in order for a supply to be zero-rated the vendor must be GST registered. However, a vendor may be registered for a purpose unrelated to the land being sold. For example, a GST registered plumber selling the family home, or a GST registered company that owns residential and commercial land and is selling the residential land. On the face of it the vendor is GST registered. However, the question of whether or not a person is GST registered in the context of the supply needs to be asked. The vendor is not GST registered for the purpose of each of the supplies above, and therefore CZR can't apply and the schedules are 'not applicable'.

Farm sales will generally fall within the CZR regime, however, most farm sales include one or more dwellings situated on the land. Broadly, the GST Act deems the supply of a dwelling to be a separate supply (i.e. two supplies exist, the dwelling and the farmland). The vendor is usually only GST registered in relation to the farmland, and as such CZR could only apply to this portion and it is 'not applicable' to the dwelling.

The treatment applying to the sale of a dwelling within which a home office exists will depend on how that office has been accounted for in the past. If, for example, a partial input tax deduction has been made on acquisition, the sale of the dwelling should be subject to GST and CZR could apply. If however, period by period or annual deductions have been made (under the change of use rules that existed before 1 April 2011) the sale should not be subject to GST.

Given the potential for tax and contractual disputes to occur, if any doubt arises throughout the course of a transaction, consideration should be given to consulting a lawyer or tax advisor.

Change in Confidentiality Case Law

The common law surrounding the level of disclosure required of employers in redundancy situations has been shaken up by the Employment Court decision, *Vice-Chancellor of Massey University v Wrigley and Kelly (2011)*.

Mr. Wrigley and Dr Kelly worked in departments that were being downsized and were made redundant whilst their colleagues retained their positions. They sought a considerable amount of information from Massey to determine whether the decisions made met the test that they were "fair and reasonable in all the circumstances".

Massey happily provided the documentation about the process but declined to provide material that was evaluative, about other people, or not in written form. Consequently Wrigley and Kelly raised a claim that Massey had failed to provide all the relevant information. This resulted in a challenge in the Employment Court as to what information should be provided.

The Court weighed up the requirements for good faith under the Employment Relations Act and the confidentiality requirements under the Privacy Act. It also sought submissions from the Privacy Commissioner on the matter.

The Employment Relations Act requires the employer to provide access to information relevant to the continuation

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of employment where it is considering termination. Information can be withheld for good reason, which is defined as complying with statutory requirements, protecting the privacy of natural persons or protecting the commercial position of the employer.

Wrigley and Kelly sought the following information:

- interview notes and ratings,
- candidate comparison sheets,
- information about successful candidates,
- reasons why they and not others were dismissed,
- facts and opinions relied on in making the decision,
- scores allocated to other candidates,
- any negative opinions formed and relied on in the process,
- the contents of discussions of the selection panel, and
- information in the minds of the selection panel.

The Court concluded that the information sought was confidential but it "did not find that protection of the privacy of those people involved in the selection process was a sufficiently good reason to maintain confidentiality of the information." and that "a fair and reasonable employer will not rely on information adverse to an employee to dismiss him…without making that information available to the employee for comment".

Massey was ordered to provide all the relevant documentation, including information comparing the candidates and the views of the panel members.

This case presents an interesting and for many an uncomfortable precedent that has occasioned considerable debate. However, for now it is the prevailing case law. Employers and those involved in selection processes should consider carefully the documentation used in the employment process in light of the fact that these documents may be required to be disclosed to the employees concerned.

Some Statistics Surrounding New Zealand's Tax System

The New Zealand tax regime has been subject to significant political debate and scrutiny in the past few years. We have seen the Tax Working Group weigh in, a GST increase to 15%, a decrease in the company tax rate to 30% and then 28%, and repeated changes to personal marginal tax rates.

The current review of the trust regime by the Law Commission could lead to further changes to the taxation of trusts and their beneficiaries.

In light of this year's Budget (which introduced a number of cost saving and revenue gathering changes) and the election in November, some facts and figures about New Zealand's tax system have been set out below:

- In 2009/2010 the Government's total tax revenue derived from taxpayers was split as follows:
  - Individuals - $21.9 billion (43%)
  - GST - $11.7 billion (23%)
  - Corporate tax - $7.3 billion (14%)
  - Other tax - $9.8 billion (19%)
- Following the Budget, the split for the 2011/2012 year is forecast to be:
  - Individuals - $24.3 billion (44%)
  - GST - $15 billion (27%)
  - Corporate tax - $8.1 billion (15%)
  - Other tax - $7.3 billion (13%)
- Before the individual tax cuts in October 2010, 12% of individual taxpayers contributed 49% of all personal income tax, while the remaining 88% of individual taxpayers contributed 51%.
- Currently, households earning less than $50,000 (43% of households) receive more in income support than they pay in income tax (on a net basis). Income tax paid by households earning between $50,000 – $110,000 effectively pays for this net refund. Households earning over $120,000 pay 97% of net individual income taxes, while the top 10% of households (those over $150,000) pay 71% of the net individual income tax revenue.
- Prior to the introduction of the 39% tax rate in 2000 there were about 20,000 trusts in New Zealand. By 2010 that number had increased to about 55,000.

KiwiSaver

- The Budget changes to KiwiSaver are expected to save $2.6 billion over four years.
- By 2015 it is estimated that KiwiSaver funds will total $25 billion and in 10 years' time will have grown to $60 billion.

Working For Families

- In the 2005/2006 year the cost of WFF was $1.5 billion. This amount has grown to $2.8 billion per year.
- The changes to the WFF package announced in the Budget are expected to save $448 million over 4 years. As a result of the changes approximately:
  - 280,000 families earning less than $70,000 per year will receive an increase to their WFF entitlements,
  - 110,000 families earning over $60,000 per year will be entitled to slightly less than they were before the changes, and
  - 7,000 families will no longer be eligible for WFF.

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Student Loans

- As at 30 June 2011 student loan debt is estimated to be $12 billion.
- Ordinarily, a loan would represent an asset to the lender. However, because interest is not charged and due to the number of borrowers who default, the Government treats 45.3% of every dollar lent as an expense.
- 15.5% of borrowers are based overseas.
- 8.6% of New Zealand based borrowers have overdue payments, compared to 37.5% of overseas borrowers.

The statistics above provide an interesting financial overview of some of the key changes and the policy direction being pursued and, in view of the November election, afford some context for evaluating political debate.

Snippets

Rental Homes for the Rugby World Cup – IRD Focus

It has been widely publicised that those who make their homes available for rent during the Rugby World Cup may face targeted scrutiny from the Inland Revenue.

The Inland Revenue itself has commented that it will be scanning sources, such as property rental web-sites and Trade Me, to identify potential rental earners and then checking their income tax returns to make sure the income has been reported.

The amount of taxable income will depend on how much rent is received and what expenses can be deducted. If rental earners are identified by the Inland Revenue as non-compliant, penalties and interest can apply.

For more information about how this is calculated, a suitable starting point is to refer to the Inland Revenue's statement on the income tax treatment of holiday homes that are rented out (see link below). While the statement relates to the use of holiday homes to derive income, it can also be applied in this context. It should be noted that depreciation on residential buildings was removed after the statement was released.

http://www.ird.govt.nz/technical-tax/questions/questions-general/qwba-0902-holiday-houses.html.

LTC Elections

The first due date for submitting elections to transition from the Qualifying Company ('QC') and/or Loss Attributing Qualifying Company ('LAQC') regime to the Look-Though Company ('LTC') regime is fast approaching. Existing QCs and LAQCs that wish to transition to the LTC regime for the income year starting on or after 1 April 2011 have to submit the election within 6 months from the start of that income year. For example, for companies with a 31 March balance date, the form must be submitted by 30 September 2011 to be effective for the 2011/2012 year.

Companies wishing to transition from the start of the 2012/2013 year have six months from the start of that year to make the election.

Existing LAQCs that wish to transition from the 2012/2013 year will effectively revert to being standard QCs for the interceding year, i.e. losses will be unable to be attributed to shareholders.

In order to make the election, an IR 862 should be completed and sent to the Inland Revenue. The form can be downloaded from the Inland Revenue website.

If you have any questions about the newsletter items, please contact me, I am here to help

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